THE EASTERN CARIBBEAN SUPREME COURT
IN THE COURT OF APPEAL

TERRITORY OF THE VIRGIN ISLANDS

BVIHCMAP2024/0009

BETWEEN:

[1] MARK BYERS
[2] MATTHEW RICHARDSON
(as Joint Liquidators of the below-named company)
[3] PIONEER FREIGHT FUTURES COMPANY LIMITED (in Liquidation)

Appellants

and

CHEN NINGNING (also known as Diana Chen)

Respondent

Before:

The Hon. Mr. Mario Michel	Chief Justice [Ag.]
The Hon. Mr. Eddy D. Ventose	Justice of Appeal
The Hon. Mde. Gertel Thom	Justice of Appeal [Ag.]

Appearances:

Mr. Tom Smith KC, with him Mr. Ben Griffiths for the appellants
Mr. Victor Joffe KC, with him Ms. Marcia McFarlane for the respondent

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2024: October 29;
2025: June 20.

Commercial appeal – Fiduciary duty of directors - The rule in West Mercia Safetywear Ltd (in liq) v Dodd and another - Whether the learned judge erred in concluding that Pioneer Freight Futures Ltd was not entitled to an order for payment by the respondent for breach of the rule in West Mercia - Whether the learned judge was correct in concluding that the question of whether the respondent had obtained a reputational benefit from the Zenato Payments was foreclosed by the decision of the Privy Council

The respondent, Ms. Chen Ningning ("Ms. Chen") was at the material time the sole director of a company called Pioneer Freight Futures Ltd ("PFF"). PFF entered into a loan agreement with Zenato Investments Ltd ("Zenato") by which Zenato paid US$13m to PFF. PFF conceded that by 23rd October 2009, it was commercially insolvent. PFF repaid its indebtedness to Zenato in three tranches on 3rd, 4th and 27th November 2009 ("the Zenato Payments"). When the Zenato Payments were made, PFF was insolvent and an insolvent liquidation or some other protective process was inevitable. The respondent was the sole authorised signatory on the account from which the Zenato Payments were made.

The appellants, as joint liquidators of PFF, subsequently brought proceedings in the Commercial Court of the Territory of the Virgin Islands against the respondent claiming the sum of US$13m together with interest alleging that the respondent breached her fiduciary duties as a *de jure* or *de facto* shadow director of PFF for causing or authorizing the Zenato Payments with the matter ultimately being appealed to the Privy Council. In a judgment dated 22nd February 2021, the Privy Council held that, first, the learned trial judge was wrong to conclude that the respondent ceased to be a *de jure* director of PFF in August 2009. Second, the respondent continued to owe fiduciary duties to PFF from August 2009 because she remained a *de jure* director.

The Privy Council further held that the respondent owed fiduciary duties to PFF at the time of the Zenato Payments and her failure to intervene to prevent the repayment of US$13m amounted to a breach of those duties. In an order dated 28th February 2022, the Board remitted to the High Court for decision all issues concerning what sums, if any, the respondent must pay to the appellants in respect of or arising from her breaches of fiduciary duty to PFF in relation to the Zenato Payments. The order also provided that the appellants were at liberty to apply to a judge of the High Court for that purpose. Pursuant to the said order the appellants applied to the High Court for orders that: 1.) the respondent do pay the appellants the sum of US$13m; and 2.) the respondent do pay the appellants interest on US$13m at the rate of 5% per annum (the "Quantum Application").

In a judgment dated 10th February 2024, the learned judge after examining *inter alia* the decisions of Stanford International Bank Ltd (in liquidation) v HSBC Bank plc and West Mercia Safetywear Ltd (in liq) v Dodd and another ("West Mercia") held that since the Zenato Payments were balance sheet neutral this meant that PFF did not suffer a net loss and that there was nothing for which PFF needs to be compensated by a payment from the respondent.

The learned trial judge also rejected the equitable remedy noting that the respondent did not benefit from the Zenato Payments in any tangible or ascertainable sense. In dismissing the Quantum Application, the learned judge concluded that the only eventual basis for making a payment order was that PFF needed to be compensated for a net loss incurred because of the Zenato Payments and since there was no such net loss to PFF, no compensation fell due.

On 22nd March 2024, the appellants filed a notice of appeal against the decision of the learned trial judge with five grounds of appeal from which the following two main issues arise for consideration, namely: 1.) whether the learned judge erred in concluding that PFF was not entitled to an order for payment by the respondent for breach of the rule in West Mercia; and 2.) whether the learned judge was correct in concluding that the question of whether the respondent had obtained a reputational benefit from the Zenato Payments was foreclosed by the decision of the Privy Council.

Held: allowing the appeal against the decision of the learned trial judge, setting aside the orders made at paragraphs 78-81 of the written judgment, ordering the respondent to pay the sum of US$13m with interest at a rate of 5% per annum (from 29th November 2009 until payment) to the appellants and directing that in the distribution of the assets of PFF to the general body of creditors the debt due to PFF is to be taken as notionally increased by US$13m to what it would have been if the Zenato Payments had not been made by the respondent in breach of the rule in West Mercia, and then any dividend attributable to the extra US$13m is to be added back to the debt of PFF and is to be recouped to the respondent rather than being paid to PFF, and awarding costs in the appeal and in the court below to the appellants to be paid by the respondent to be assessed if not agreed within 21 days of today's date, that:

1. Once a company is insolvent or bordering on insolvency, the interests of the company for the purposes of the director's fiduciary duty are extended to include the interests of the company's creditors as a whole. This further extension is a recognition that for some purposes, the interests of the company are to be regarded as including the interests of a third party that is distinct from the company as a corporate entity. Thus, where the rule of West Mercia applies, the interests of the general body of creditors are to be regarded as the same as the interests in the company. In essence, where the rule in West Mercia applies, the principle of separate legal personality serves a new function, that is, to protect the interests of creditors entitled to the protection that the rule provides.

   West Mercia Safetywear Ltd (in liq) v Dodd and another [1988] BCLC 250 applied; **Saloman v A Saloman & Co Ltd** [1897] AC 22 applied.

2. The remedy granted in West Mercia was based on the breach of the rule. Although the action of the director in making the payment for his own benefit which amounted to what was called a "blatant misfeasance" loomed large in the decision of the Court of Appeal in West Mercia, it cannot be said that when properly read in context that that feature was the sole basis or an important factor that informed the reasoning of the Court of Appeal in respect of the remedy granted. The decision therefore accepts that a repayment of any sums paid in breach of the rule in West Mercia is an appropriate form of relief. For the purposes of determining the loss caused by a breach of the rule in West Mercia, any loss to the general body of creditors must be equated with that of the company. If this were not the case, directors would act with impunity in breach of the rule comforted in the knowledge that once the transaction is balance sheet neutral, the company would suffer no financial loss and consequently the directors will not be liable at all for any such breach.

   West Mercia Safetywear Ltd (in liq) v Dodd and another [1988] BCLC 250 applied; **Bilta (UK) Ltd (in liquidation) and others v Nazir and others (No 2)** [2016] AC 1 considered.

3. The learned trial judge held that since the Zenato Payments were balance sheet neutral, this meant that PFF did not suffer a net loss and that consequently, there was nothing for which PFF needs to be compensated by a payment from the respondent. Had the learned trial judge accepted that the loss to the body of creditors is to be regarded as a loss to the company in the context of a breach of the rule in West Mercia, he would not have arrived at this conclusion. In doing so, the learned trial judge erred in principle. Indeed, any financial benefit to the respondent is not a relevant consideration in determining whether the company suffered any loss because of her established breach of the rule in West Mercia.

   AIB Group (UK) plc v Mark Redler & Co Solicitors [2015] AC 1503 considered; **BTI 2014 LLC v Sequana SA and others** [2024] AC 211 applied; **Stanford International Bank Ltd (in liquidation) v HSBC Bank plc** [2023] AC 761 distinguished.

4. Having considered whether an equitable remedy along the lines crafted in West Mercia should be applied, the learned trial judge answered in the negative. In doing so, the learned judge was also wrong in principle as the rule in West Mercia was directly engaged in the earlier proceedings in which the Privy Council had found the respondent had breached the rule. Further, the decision in West Mercia was approved in Sequana. It was therefore not open to the learned trial judge to reject the remedial approach adopted by the Court of Appeal in West Mercia. In rejecting that equitable remedy, the learned trial judge noted that that the director in West Mercia had indirectly obtained a benefit from the improper preference paid. The issue of a benefit is not a feature of the rule of West Mercia and the learned judge was accordingly wrong to treat it as a precondition for the application of the rule.

   West Mercia Safetywear Ltd (in liq) v Dodd and another [1988] BCLC 250 applied; **BTI 2014 LLC v Sequana SA and others** [2024] AC 211 applied.

5. The learned judge was wrong to dismiss the Quantum Application on the basis that the only eventual basis for making a payment order was what PFF needed to be compensated for a net loss incurred because of the Zenato Payments and since there was no such net loss to PFF, no compensation fell due. In making the Zenato Payments, the company suffered a pecuniary loss equivalent to the financial loss suffered by the general body of creditors.

JUDGMENT

[1] **VENTOSE JA:** This appeal raises an issue of great importance in company law. The question is whether a director of a company is liable for loss suffered by the general body of creditors in respect of a payment made by that director to a creditor of the company in breach of the rule in **West Mercia** where that payment is balance sheet neutral.

The Factual Background

[2] The starting point in this appeal is the background facts as stated by the Privy Council in its decision in **Byers v Chen Ningning**[1] dated 22nd February 2021. The respondent, Miss Chen, at the material time was the sole director of a company called Pioneer Freight Futures Ltd ("**PFF**"). PFF entered into a loan agreement with Zenato Investments Ltd ("**Zenato**") by which Zenato paid US$13m to PFF. PFF conceded that by 23rd October 2009, the last day of a High Court trial in London in which PFF was a defendant, it was commercially insolvent. PFF repaid its indebtedness to Zenato in three tranches on 3rd, 4th and 27th November 2009 (the "**Zenato Payments**"). When the Zenato Payments were made PFF was insolvent and an insolvent liquidation or some other protective insolvency process was inevitable.

[3] The appellants, the joint liquidators of PFF, brought proceedings in the Commercial Court of the Territory of the Virgin Islands against the respondent claiming the sum of US$13m together with interest alleging that the respondent breached her fiduciary duties as a *de jure* or *de facto* shadow director of PFF for causing or authorizing the Zenato Payments. The trial judge in a judgment dated 19th March 2015 found that the respondent had ceased to be a director at about the beginning of August 2009 and owed no fiduciary duties at the time of the Zenato Payments, and that consequently the respondent did not act in breach of any fiduciary duty. On appeal, this Court in a judgment dated 12th June 2018 found that the trial judge was entitled to find that the respondent: (1) owed no fiduciary duties to PFF at the time of the Zenato Payments; and (2) did not cause or procure the Zenato Payments.

[4] On further appeal to the Privy Council, the Board held that, first, the trial judge was wrong to conclude that the respondent ceased to be a *de jur*e director of PFF in August 2009. Second, the respondent continued to owe fiduciary duties to PFF after the beginning of August 2009 because she remained a *de jure* director. The respondent was the sole authorised signatory on the account from which the Zenato

[1] [2021] UKPC 4, [2021] 3 LRC 434.

Payments were made. In answering the question of whether the respondent acted in breach of her fiduciary duties, the Board stated that:

> "[91] The next question is whether, by failing to intervene to prevent the Zenato Payments, Miss Chen acted in breach of her fiduciary duties to PFF. As we have said, Miss Chen was a *de jure* director of PFF and she was the sole authorised signatory on the account from which the Zenato Payments were made. At all times after the Marine Trade judgment, PFF's insolvent liquidation or some other protective insolvency regime was inevitable and, as the judge found, this was under active discussion between Miss Chen and others on behalf of PFF, on the one hand, and HFW, on the other, 'a matter of days' afterwards. It is not necessary for the purposes of this appeal to explore the boundaries of the fiduciary duty owed by a director of an insolvent company for the Board has no doubt that, in the circumstances we have described, when making or authorising payments from PFF's account, Miss Chen had a fiduciary duty to act honestly and in good faith in what she believed to be the best interests of PFF and, through PFF, as an insolvent company, in the best interests of its creditors. Similarly, she had a duty to exercise her powers as a director for proper purposes, that is to say, once PFF became insolvent, for purposes which would further the interests of PFF's creditors. Further, in light of PFF's insolvency, the normal principle that Miss Chen, as the ultimate owner of PFF, could waive or ratify any such breach of duty was displaced.
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> [93] The judge found that Mr. Chen was responsible for repaying the Zenato loan and that by this time he was in charge of PFF's affairs as sole *de facto* director. He also found that banking transactions were in practice conducted electronically by PFF's staff without Miss Chen having to sign anything, and that the payments to Zenato were made in this way. However, Miss Chen was, on the judge's findings, aware of these payments. What is more, Miss Chen had a fiduciary duty to PFF to take all reasonable steps to intervene to prevent a payment being made from a trading account of which she was sole signatory for an improper purpose. The repayment of the whole of the Zenato loan was undoubtedly improper. It was made at a time when PFF was insolvent and without any proper reason. Yet Miss Chen took no steps to prevent it. Moreover, given Miss Chen's position in relation to PFF as *de jure* director and sole beneficial owner and given further that she was the sole signatory on the account, there can be no doubt that, had she intervened, the payments would not have been made. She was, as the judge described, 'ultimately the boss'. In these circumstances the Board is satisfied that her inaction amounted to a breach of her fiduciary duty to PFF."

[5] Considering this finding, the Board found it unnecessary to consider whether the liquidators could also have a remedy under sections 244 and 245 of the Insolvency Act 2003, explaining as follows:

> **"The claim under the Insolvency Act 2003**
> [96] Nor is it necessary for the Board to consider this additional limb of the Liquidators' claim. Both the judge and the Court of Appeal rejected it, but for very different reasons. In the Board's view, our conclusion that Miss Chen is liable to account for breach of fiduciary duty makes any investigation of the question whether the Liquidators have, in addition, a remedy under sections 244 and 245 of the Insolvency Act 2003 simply unnecessary. Miss Chen's liability to account will be a sufficient remedy for the Liquidators, and a parallel remedy under the Act, although discretionary as to its precise extent, could not provide for them anything of greater value than they will obtain from the Board's conclusion that she was in breach of fiduciary duty by failing to prevent the Zenato payments. The Liquidators have not submitted to the contrary, at least before the Board. Nor do we need to address the question whether, as the Liquidators have contended, Miss Chen derived a reputational benefit from the making of the payments."

[6] At para [98], the Privy Council allowed the appeal, stating that the respondent owed fiduciary duties to PFF at the time of the Zenato Payments and her failure to intervene to prevent that repayment amounted to a breach of those duties. The Privy Council continued that it would invite submissions from the parties as to the appropriate form of order in the light of this judgment. These submissions were duly filed and the appropriate form of order handed down by the Privy Council on 28th February 2022, after declaring that: (1) the respondent owed fiduciary duties to PFF at the time of the Zenato Payments and (2) the respondent breached her fiduciary duties to PFF in relation to the Zenato Payments, in relevant part, was as follows:

> "2. All issues concerning what sums, if any, the respondent must pay to the appellants in respect of or arising from her breaches of fiduciary duty to PFF in relation to the Zenato Payments be remitted to the High Court for decision, in the first instance, by a Judge of that Court.
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> 3. The appellants have liberty to apply to a Judge of the High Court for that purpose and for appropriate directions, such application to be made within 28 days of the date of this order, and for an order for payment of all sums found due, if any, together with interest at such a rate and such a period as the Judge may decide is appropriate."

The decision in the court below

[7] Pursuant to paragraph 3 of the order of the Privy Council, the appellants applied on 17th March 2022 with supporting affidavit for, among other things, the following orders: (1) the respondent do pay the appellants the sum of US$13m; and (2) the respondent do pay the appellants interest on US$13m at a rate of 5% per annum [above 29th November 2009] (the "**Quantum Application**").

[8] The Quantum Application came on for hearing before the learned trial judge on 4th-5th July 2023 and in a judgment dated 10th February 2024, the learned trial judge after examining: (1) terms of the order of the Privy Council at para [2] of its 28th February 2022 order and para [96] of its judgment in **Byers v Chen Ningning** (paras [36]-[51]; (2) the decisions of the United Kingdom Supreme Court (UKSC) in **Stanford International Bank Ltd (in liquidation) v HSBC Bank plc**[2] ("**Stanford**"), **AIB Group (UK) plc v Mark Redler & Co Solicitors**[3] ("**AIB**") [para [52]-[59]]; and (3) the decision of the Court of Appeal of England and Wales in **West Mercia Safetywear Ltd (in liq) v Dodd and another**[4] ("**West Mercia**"), held at para [67] that since the Zenato Payments were balance sheet neutral this meant that PFF did not suffer a net loss. The learned trial judge continued that, consequently, there was nothing for which PFF needs to be compensated by a payment from the respondent.

[9] The learned trial judge continued at para [68] that requiring the respondent to make any payment would be penal and that it was no part of the appellants' case that the respondent obtained a financial benefit by making the Zenato Payments. The learned trial judge also considered whether an equitable remedy along the lines crafted in **West Mercia** should be applied. In rejecting that equitable remedy, the learned trial judge noted at para [69] that the director in **West Mercia** had indirectly obtained a benefit from the improper preference paid, and at para [70] that the respondent did not benefit from the Zenato Payments in any tangible or ascertainable sense. The learned trial judge noted that the Privy Council at para [96] of its judgment in **Byers**

[2] [2023] AC 761.
[3] [2015] AC 1503.
[4] [1988] BCLC 250.

v Chen Ningning had ruled that it was not necessary to determine that issue and that he would likewise not do so.

[10] The trial learned judge, in dismissing the Quantum Application, concluded at para [78] that: (1) the only eventual basis for making a payment order was that PFF needed to be compensated for a net loss incurred because of the Zenato Payments; and (2) since there was no such net loss to PFF, no compensation fell due.

The Appeal

[11] On 22nd March 2024, the appellants filed a notice of appeal against the decision of the learned trial judge with five grounds of appeal from which the following two main issues arise for consideration in this appeal: (1) whether the learned judge erred in concluding that PFF was not entitled to an order for payment by the respondent for breach of the rule in **West Mercia**; and (2) whether the learned trial judge was correct in concluding that the question of whether the respondent had obtained a reputational benefit from the Zenato Payments was foreclosed by the decision of the Privy Council in **Byers v Chen Ningning**.

The appellants' submissions

[12] The appellants submit that the learned trial judge was wrong to have concluded that Miss Chen had no liability to PFF on the basis that her breach of duty had not caused any loss to PFF on a balance sheet basis. The appellants also submit that if the learned trial judge were correct it would have the surprising and unsatisfactory result that directors who, in breach of the rule in **West Mercia**, cause their companies to make a preferential payment to an individual creditor at a time when their company is insolvent and on the eve of entering insolvent liquidation would not be liable to pay compensation for that breach of duty. The appellants continue that this is notwithstanding that the making of such payments clearly causes loss to individual creditors by reducing the amount of assets available for distribution. In the appellants' view that would be highly incongruous because the very obligation on the director is to treat the interests of the creditors as a whole as paramount, and in making the

preferential payment the director fails to do so and acts contrary to the interests of creditors, and yet on the analysis of the learned trial judge such a payment does not give rise to any recoverable loss. The appellants contend that the effect of the conclusion of the learned trial judge would be to severely undercut the scope and effect of the rule in **West Mercia,** and it would be inconsistent with the leading authority of **West Mercia** directly on this point.

[13] The appellants submit that, first, the rule in **West Mercia** is a facet of the fiduciary duty of directors to act in what they consider to be the best interests of the company. Second, where the company's financial position is such that the directors knew or ought to know that insolvency is imminent or it is probable the company will enter an insolvent liquidation or administration, the interests of the company are not the interests of its shareholders but rather the interests of the company's creditors. The interests of the creditors at that stage are to be treated as paramount. Third, the rationale for the rule in **West Mercia** is that, where it arises the company's creditors have the economic interest in the company, based on their entitlement to be paid the debts owed to them, ultimately enforceable against the proceeds of realization of the company's assets.

[14] In relation to loss suffered, the appellants submit that it is not correct, as the learned trial judge did, simply to treat the payment of an individual debt as 'balance-sheet neutral' and thus as causing no relevant loss. The appellants also submit that the effect of such payment is to deprive the company of real assets, such that they will no longer be available for distribution to creditors on an insolvent liquidation, in circumstances where (but for the director's breach of duty) the company would not in fact ever have paid the liability in question in full. The appellants continue that, instead, the creditor would have been left to prove in the insolvent liquidation and receive a *pari passu* distribution. The appellants contend that the economic reality is that the creditors suffer loss by reason of the payment because what matters to the creditors is that the company has available assets from which they can receive distributions. The appellants also contend that, at this stage, the interests of creditors

have displaced those of shareholders in the company; and that the assets of the company in a practical sense belong to its creditors through the medium of the company.

[15] The appellants continue that the question of what constitutes “loss” to the company itself cannot be divorced from these considerations; in circumstances where the interests of creditors have displaced those of shareholders in the company, the action which causes loss to the creditors and which infringes their interests must also be the action which causes loss to the company for the purposes of the rule in **West Mercia**. In the appellants’ view, this was also supported by the content of the rule in **West Mercia** which is imposed on a director (as opposed to a third party outside the company) concerning the management of the business and affairs of the company itself (again as opposed to the actions of a third party outside the company) in a situation where the interests of the company are to be equated with those of its creditors as a whole and it is those interests which the law requires to be treated as paramount by the directors. The appellants contend the very obligation imposed on directors by the rule in **West Mercia** in circumstances where insolvency is inevitable is to seek to preserve or enhance the value of the company’s assets pending distribution to creditors *pari passu*, and not to pay those assets to select creditors on a preferential basis.

[16] The appellants submit that the rule in **West Mercia** would be severely undermined – and might be said to be a not very useful duty – if the position was that there was no effective remedy against a director who breached that duty by causing a payment to be made away to prefer one creditor at a time when the company was insolvent. The appellants also submit that coherence in the law demands that where the law imposes a duty then it should also provide for an effective remedy for breach of that duty. The appellants continue that on the analysis of the learned trial judge, directors would never be liable for preferential payments made by the company, however imminent insolvent liquidation was and however improper the payment, unless it could be shown that the director had personally benefitted in a tangible or readily

ascertainable way. In the appellants' view, that would leave a significant lacuna, with no remedy being available for serious breaches of the fundamental fiduciary duties of directors.

[17] The appellants submit that their position is supported by the decision of the Court of Appeal of England and Wales in **West Mercia** and that is directly on point in these proceedings and should have been followed by the learned trial judge. In that decision, the Court of Appeal ordered the director to repay a sum of money that was paid by the company at a time when it was insolvent. The appellants contend that the Court of Appeal proceeded on the basis that the payment by the company of the sum of money in these circumstances had caused loss to the company. The appellants also note the following: (1) at the time at which the payment was made the company was clearly insolvent and would inevitably have to enter insolvent liquidation; (2) the interests of the company at that point were reflected entirely in the interests of its creditors as a whole; and from the creditors' perspective what mattered was that there were assets available to be distributed amongst them; (3) it appears to have been obvious to Dillon LJ and the Court of Appeal that the fact that the repayment of a liability was technically balance sheet neutral was not a bar to substantive relief against the director; and (4) in practical terms, the repayment of the debt caused an obvious loss to the company and its creditors.

[18] The appellants contend that Lord Reed in **BTI 2014 LLC v Sequana SA and others**[5] ("**Sequana**") considered the application of the rule in **West Mercia** to preferential payments and specifically the question of loss, and that he expressed his "provisional view" that the Court of Appeal in **West Mercia** was correct in its approach to the relief in that case. In other words, the grant of pecuniary relief was not dependent on the company having suffered a loss in the "conventional, balance-sheet, sense" but instead the funds available to the company to meet the claims of the general body of creditors were depleted because of the director's breach of the rule in **West Mercia**.

[5] [2024] AC 211.

[19] The appellants contend that the learned trial judge was wrong to distinguish the decision in **West Mercia** on the ground that the defaulting director in that case had obtained a personal benefit which was capable of being ascertained financially. The appellants contend that the Court of Appeal in **West Mercia** held that the defaulting director was liable to pay the company because he had failed to establish that the company had not suffered loss and, as Dillon LJ noted, the proposition that there had been no loss was "surprising".

[20] The appellants state that the reasoning of the learned trial judge was, in essence, that the legal landscape had changed since **West Mercia** by reason of the UKSC's decisions in **AIB** and **Stanford,** and as a result the ability of the court to grant equitable relief as the Court of Appeal did in **West Mercia** was now exceptional, limited to a residual basis that would rarely be necessary to apply and not extending beyond situations in which the defaulting director had received a personal benefit. In response, the appellants submit that that reasoning is inconsistent with the decision of the Court of Appeal in **West Mercia** and the provisional views expressed by Lord Reed and Lady Arden in **Sequana** and that it is not a result which follows from either **AIB** or **Stanford**. The appellants also submit that neither **AIB** nor **Stanford** concerned the rule in **West Mercia** and neither case therefore casts any doubt about the displacement of the interests of shareholders in a company by those of the creditors, and the circumstances in which the law will treat a company as having suffered loss for the purposes of founding a claim for breach of the rule in **West Mercia.** The appellants continue that neither case deals with the fundamental point that the interest of creditors in an insolvent company lies in maximising the total amount of assets available for distribution to creditors as a whole, and that such creditors therefore suffer loss by having such assets diminished, even if the effect of any such step can be said to be 'balance sheet neutral'.

[21] In respect of the second issue in the appeal, the appellants submit that even if (contrary to their primary case) the learned trial judge was right to conclude that no relief could be granted unless Miss Chen had benefitted from the Zenato Payments,

he was wrong to exclude from consideration the fact that Miss Chen had allowed the Zenato Payments to be made for her own benefit. The appellants also submit that the approach of the learned trial judge was based on what he considered as the effect of the decision of the Privy Council in the earlier appeal to be to exclude any question of benefit for Miss Chen from consideration. In response, the appellants contend that that was not what the Privy Council determined – its conclusion was that it did not need to address the question of whether Miss Chen derived a reputational benefit from the making of the payments. In the appellants' view, that did not amount to a finding or direction that the issue was necessarily irrelevant for all purposes in any further determination in these proceedings or should not be determined, even if relevant, at a future stage in the proceedings. The appellants continue that, if anything is to be taken from the judgment of the Privy Council on this point, it is that the Privy Council did not consider the quantum of Miss Chen's liability to the appellants could or would turn on the question whether she benefitted from the making of the Zenato Payments.

[22] The appellants contend that the effect of the decision of the learned trial judge was to refuse the appellants' claim on the basis that relief could be granted only where Miss Chen could be shown to have benefitted from the Zenato Payments whilst simultaneously declining to consider whether Miss Chen had benefitted from the Zenato Payments on the basis that the Privy Council had not considered this relevant. In the appellants' view, the approach of the learned trial judge was manifestly unfair to the appellants and indeed absurd. The appellants conclude that if the learned trial judge had considered this point, he should and would have concluded that the evidence indicated that Miss Chen did derive a reputational benefit from the Zenato Payments, and that there was evidence from which that conclusion could and should properly have been drawn.

[23] The appellants submit that at para [70] of the judgment, the learned trial judge stated that Miss Chen did not benefit from the Zenato Payments, or at least did not do so "in any tangible or readily ascertainable sense". In the appellants' view, taken in

context, the learned trial judge was therefore saying, at most, that Miss Chen had not enjoyed an immediate financial benefit from the Zenato Payments, not that she had necessarily not enjoyed any benefit at all. The appellants submit that this is clear from the fact that the judge went on in the same paragraph to refer to the appellant's argument that Miss Chen had obtained a reputational benefit from the Zenato Payments but that the Privy Council had ruled it was not necessary to determine that issue and he "will likewise therefore not do so". The appellants also submit that, nonetheless, to the extent that (contrary to their position) the learned trial judge did find that Miss Chen did not enjoy even a reputational benefit from the Zenato Payments, he was wrong to do so.

The respondent's submissions

[24] The respondent submits in summary the following. First, losses suffered by PFF's creditors are legally distinct from losses suffered by PFF and that there is no basis to conflate or elide the two. In this regard, the appellants' reliance on the nature and purpose of the duty to consider creditors' interests is wholly misplaced. Second, the appellant has taken **West Mercia**, as well as various dicta about **West Mercia**, out of context, and that the learned trial judge was entirely correct to distinguish **West Mercia** from the facts of this case. Third, the appellants' attempt to resurrect the "reputational benefit" argument is hopeless, because the Privy Council was clear that the issue does not require further determination; and that, in any event, the issue has been considered and dismissed and or brushed aside by a total of 10 judges on four previous occasions. The respondent submits that the allegation that Miss Chen derived a "reputational benefit" from the Zenato Payments is neither plausible nor supported by evidence.

[25] The respondent submits that it is not disputed between the parties that when a company is financially distressed the directors' fiduciary duty to the company to act in its best interests includes considering the creditors' interests – the rule in **West Mercia**. The respondent continued that what is disputed, however, is that this trite legal proposition should lead to the appellants' conclusion that PFF suffered a

compensable loss in circumstances where the Zenato Payments extinguished PFF's liability to Zenato and did not result in any change in PFF's net asset position. The respondent contends that the appellants' argument is wholly untenable because there is nothing about the nature or purpose of the rule in **West Mercia** that allows the appellant to elide the losses suffered by PFF with the losses allegedly suffered by PFF's creditors. The respondent also contend that not only is the appellants' argument unsupported by any authority, but it also directly runs counter to the UKSC's analysis in **Stanford**.

[26] The respondent contends that as a matter of law, Miss Chen owed her duty in accordance with the rule in **West Mercia** to PFF and not to PFF's creditors directly. The respondent also contends that the rule in **West Mercia** is simply an aspect of a director's fiduciary duties to the company, rather than a free-standing duty owed to the creditors. The respondent submits that the Privy Council was alive to this distinction at paras [93] and [98] of its judgment. Citing from the decision of Lord Leggatt in **Stanford**, the respondent also submits that the appellants' argument is fundamentally inconsistent with the basic doctrine of separate legal personality. The respondent contends that the appellants' submission must fail because, once the appellants' attempt to elide the losses suffered by PFF and PFF's individual creditors is rejected, the conclusion of the learned trial judge must follow. In the respondent's view, since there was no dispute that the Zenato Payments were balance sheet neutral transactions, PFF simply suffered no loss. The respondent also contends that there is no substance in the appellants' argument that where the law imposes a duty the law should also provide an effective remedy. The respondent clarifies that equitable compensation is ordered where a company has suffered loss because of a breach of duty; equitable compensation is not ordered simply because there is a duty or a breach of duty. In addition, the respondent also explains that there is no lacuna in the law if PFF is unable to recover compensation from Miss Chen. The respondent submits that since the alleged loss is ultimately one that is suffered by PFF's creditors, it is entirely up to and open to PFF's creditors to take other steps to recover their alleged losses.

[27] The respondent submits that the appellants' argument that the learned trial judge erred in excluding from consideration the fact that Miss Chen derived a reputation benefit from the Zenato Payments it is totally devoid of any merit. The respondent also submits for reasons explained in the judgment; the learned trial judge was correct in saying that the Privy Council had excluded the reputational benefit issue from consideration in determining what sums if any Miss Chen should pay PFF. The respondent contends that, in any event, the burden is on the appellants to prove the "reputational benefit" in question, and that their only evidence is a non-verbatim note (the "**Note**") of an interview with a staff member of PFF. The Note has been shown to be flawed in a few major aspects. The respondent also contends that the appellants did not give that staff member the opportunity to confirm the contents of the Note, and the staff member later refuted its contents.

[28] The respondent explains that: (1) in March 2015, the "reputational benefit" point first came before the trial judge Bannister J who, in his judgment, pointed out the Note's flaws and criticized the liquidators; (2) this Court expressed approval of Bannister J's approach to the evidence of the Note and commented that the allegation of reputational benefit did not advance the appellant's case, because the amounts of the Zenato Payments were insignificant by comparison with other debts owed by PFF; (3) the issue then came before the Privy Council, which brushed aside the allegation of reputational benefit within a single sentence in para [96]; (4) the argument came before the court for the fourth time in the Quantum Application, and was again rejected by the learned trial judge in his judgment; and (5) the appellants now seek to raise the "reputational benefit" point again, with the same lack of analysis as to why and how the court should or could find as a matter of fact that Miss Chen derived "reputational benefit" from the Zenato Payments. The respondent concludes that the second ground is doomed to fail.

The decision of the Court of Appeal in West Mercia

[29] Until the decision of the UKSC in **Sequana**, the leading authority in England and Wales concerning the creditor interest duty was the decision of the Court of Appeal

in **West Mercia**. Now that the UKSC in **Sequana** has accepted that directors have a duty at common law to consider and give appropriate weight to the interests of the company's creditors when they know or ought to know that the company is insolvent or bordering on insolvency, the questions which did not arise in that decision but were nonetheless important ones were flagged by Lord Reed. At para [3], he noted that the proposition that directors are under a duty to creditors raises a number of questions, including: (1) what are the consequences of a breach of the duty; and (2) in particular, what forms of relief are available? Before looking at Lord Reed's provisional views in answering these questions, it is necessary to examine the decision of the Court of Appeal in **West Mercia** in some detail as it is the first decision in England and Wales to provide an answer to some of these questions.

[30] The facts of **West Mercia** are summarised in the headnote as follows. West Mercia Safetywear Ltd ("**West Mercia Ltd**") was a wholly owned subsidiary of A J Dodd & Co Ltd (**Dodd Ltd**). Mr. Dodd was a director of both companies. Both companies banked with the same bank. Dodd Ltd's overdraft at the bank was guaranteed personally by Mr. Dodd. In May 1984, West Mercia Ltd owed Dodd Ltd about £30,000.00. At this time, both companies were in financial difficulties and an accountant told Mr. Dodd that the companies' bank accounts were not to be operated. On 21st May 1984, Mr. Dodd transferred £4,000.00 from the West Mercia Ltd account to the Dodd Ltd account. In June both companies went into liquidation. The appellant, the liquidator of West Mercia Ltd, applied for a declaration that Mr. Dobb was guilty of misfeasance and breach of trust and that he be ordered to repay the £4,000.00 transferred from West Mercia Ltd to Dodd Ltd. The judge held that although Mr. Dodd had acted improperly, he had not breached any duty to West Mercia Ltd because the transfer of £4,000.00 was payment in part of a debt owed by West Mercia Ltd to Dodd Ltd and was not therefore a misapplication of West Mercia Ltd's assets. The liquidator appealed to the Court of Appeal of England and Wales.

[31] Dillon LJ (with whom Croom-Johnson LJ and Caulfield J agreed) approved the following statement of Street CJ in **Kinsela v Russell Kinsela Pty Ltd (in liq)**[6] where he said:

> "In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."

[32] Dillon LJ accepted that, on the facts, West Mercia Ltd was insolvent when Mr. Dodd transferred the sum of £4,000.00 from West Mercia Ltd to Dodd Ltd in that: (1) West Mercia Ltd was at the relevant time insolvent to the knowledge of the directors, including Mr. Dodd; and (2) the directors had been expressly told not to deal with the West Mercia Ltd's bank account. Dillon LJ concluded at p 253 that "Mr Dodd was guilty of breach of duty when, for his own purposes, he caused the £4,000 to be transferred in disregard of the interests of the general creditors of this insolvent company". This has become known as the "rule in **West Mercia**" and since the decision of the UKSC in **Sequana,** the existence of the rule as a matter of English law has been put beyond question.

The decision of UKSC in Sequana

[33] The confirmation of the existence of the rule in **West Mercia** was achieved by the recent decision of the United Kingdom Supreme Court in **Sequana** which was not mentioned in the judgment of the learned trial judge. In answering the question of whether there is a rule (the rule in **West Mercia**) that in certain circumstances the interests of the company, for the purpose of the directors' duty to act in good faith in

[6] (1986) 4 NSWLR 722 at 730.

its interests, are to be understood as including the interests of its creditors as a whole, Lord Reed answered as follows:

> "76 This is the most fundamental question raised by this appeal. I answer it in the affirmative. It is clear that such a rule was recognised by the Court of Appeal and lower courts before the enactment of the 2006 Act. The existing law in this regard was preserved by section 172(3) of that Act, as this court has previously accepted in the cases of Bilta (UK) Ltd v Nazir (No 2) [2016] AC 1 and MacDonald v Carnbroe Estates Ltd [2020] 1 BCLC 419. I am satisfied that the rule has a sound legal basis, as explained in paras 46–51 above.
>
> 77 It is important to understand that the rule in West Mercia does not create any new duty: it merely adjusts the long-established fiduciary duty to act in good faith in the interests of the company. Where the rule applies, the way in which the company's interests are understood, for the purposes of that duty, is extended so as to encompass the interests of the general body of creditors as well as the interests of the general body of shareholders. That reflects a recognition that the traditional identification of the interests of the company with those of its shareholders, although satisfactory when the company is financially stable, needs to be widened when insolvency is imminent. The interests of the creditors as a whole should then also be taken into account and given appropriate weight, as explained in para 81 below. If insolvent liquidation or administration is unavoidable, the interests of the shareholders drop out of the picture, and the company's interests can be treated as equivalent to those of the creditors alone."

[34] In explaining the content of the duty arising where the rule in **West Mercia** applies, Lord Reed stated that:

> "79 As I have explained, it seems to me that the effect of the rule in West Mercia is to preserve the directors' duty to act in the interests of the company, but to modify the sense of the latter expression so that, where the rule applies, the interests of the company are no longer regarded as solely those of its shareholders but are understood as including those of its creditors as a whole. That was the view adopted in Kinsela and approved in West Mercia. It was endorsed by Lord Toulson and Lord Hodge JJSC in Bilta (UK) Ltd v Nazir (No 2) [2016] AC 1, para 123, in remarks with which I agree:
>
>> 'It is well established that the fiduciary duties of a director of a company which is insolvent or bordering on insolvency differ from the duties of a company which is able to meet its liabilities, because in the case of the former the director's duty towards the company requires him to have proper regard for the interest of its creditors and prospective creditors. The principle and the reasons for it were set out with great clarity by Street CJ in Kinsela …'

They added, at para 126:

> ‘the protection which the law gives to the creditors of an insolvent company while it remains under the directors” management is through the medium of the directors” fiduciary duty to the company, whose interests are not to be treated as synonymous with those of the shareholders but rather as embracing those of the creditors.’

80 Some authorities have gone further. In Bilta (UK) Ltd v Nazir (No 2), para 104, Lord Sumption JSC summarised the effect of the rule in West Mercia as ‘treating the interests of an actually or prospectively insolvent company as synonymous with those of its creditors’. A similar view was expressed by Nourse LJ in Brady v Brady [1988] BCLC 20 (para 50 above), and has also been accepted in some of the more recent decisions at first instance. However, those dicta appear to me to go further than is justified by the rationale of the rule in West Mercia, as I explained at para 50 above. It is only where an insolvent liquidation or administration is unavoidable that the shareholders cease to have any interest in the company, and their interests can therefore be left out of account.

81 Where the company is insolvent or bordering on insolvency but is not faced with an inevitable insolvent liquidation or administration, the directors’ fiduciary duty to act in the company's interests has to reflect the fact that both the shareholders and the creditors have an interest in the company's affairs. In those circumstances, the directors should have regard to the interests of the company's general body of creditors, as well as to the interests of the general body of shareholders, and act accordingly. Where their interests are in conflict, a balancing exercise will be necessary. Consistently with what was said in Kinsela 4 NSWLR 722, 733 (para 33 above), and with the reasoning in paras 48–59 above, it can I think be said as a general rule that the more parlous the state of the company, the more the interests of the creditors will predominate, and the greater the weight which should therefore be given to their interests as against those of the shareholders. That is most clearly the position where an insolvent liquidation or administration is inevitable, and the shareholders consequently cease to retain any valuable interest in the company.”

[35] Lord Briggs (with whom Lord Kitchen agreed) gave his own reasons for dismissing the appeal which are not altogether different from that of Lord Reed. Lord Hodge agreed with the reasons given by Lord Briggs, summarising at para [247] his views as follows: (i) the fact that a company faces a real risk of insolvency is not sufficient to give rise to the **West Mercia** duty; (ii) the **West Mercia** duty can apply to a decision to pay a lawful dividend; (iii) the **West Mercia** duty is a recognition of the economic interests or stakeholding in the company of its creditors when the company is

bordering on insolvency or is insolvent; (iv) where a company is insolvent or bordering on insolvency the **West Mercia** duty involves a fiduciary duty of the directors to the company to take into account and give appropriate weight to the interests of the company's creditors as a body; and (v) where the company is irretrievably insolvent, the interests of those creditors become a paramount consideration in the directors" decision-making.

[36] Lady Arden stated at para [398] that the issue in **West Mercia** was whether the subsidiary could show any loss because the payment resulted in an equivalent reduction in its liabilities. She continued at para [401] that the thrust of Dillon LJ's reasoning turned on improper purpose and that "[h]aving now reflected on this passage since the hearing of this appeal, it seems to me that Dillon LJ relied on the general duties of directors, specifically the duty to exercise powers for a proper purpose, and not on any duty in relation to creditors".

The Principle of Separate Legal Personality

[37] The starting point in the resolution to the central issue in this appeal of whether a director of a company is liable to repay to that company a sum of money paid to a creditor in circumstances where the director has breached the rule in **West Mercia**, and the payments were balance sheet neutral, is an understanding of one of the fundamental pillars of company law, namely, separate legal personality and the manner in which the courts have departed from this principle over time. The principle emerging from the decision of the House of Lords in **Salomon v A Salomon & Co Ltd**[7] is that a company is a distinct entity and, importantly, it is separate from its shareholders. However, as Lord Reed notes at para [19] of **Sequana**, the company was nevertheless regarded, for the purposes of the directors' duty to act in its interests, as being its collective membership. Lord Reed explained at para [21] that although this principle of separate legal personality was firmly established, the courts had to ascertain over time what interest could be considered as that of the company. He continued that, for the purposes of the directors' duty to act in the interests of the

[7] [1897] AC 22.

company, the company's interests were traditionally equiparated with those of its shareholders, not its creditors (at para [26]). Lord Reed made clear that, as a company is financially stable, and is therefore able to pay its creditors in a timely manner, the interests of its shareholders as a whole, understood as a continuing body, can be treated as the company's interests for the purposes of the directors' duty to act in its interests (at para [47]). This position alters when the company is insolvent or bordering on insolvency where the company's creditors as a whole become persons with a distinct interest (possibly, depending on the gravity of the company's financial difficulties, the predominant interest) in its affairs, as they are dependent on its residual assets, or on the possibility of a turnaround in its fortunes, for repayment (at para [48]).

[38] Lord Reed cautioned that this did not mean that the interests of the shareholders vanish whenever a company becomes insolvent or is bordering on insolvency (at para [50]), explaining that:

> "51 Against that background, the nuanced approach adopted in Kinsela makes sense: that is to say, an approach which recognises that where a company is insolvent or bordering on insolvency, the way in which the interests of the company are understood, for the purposes of the directors' duty to act in good faith in its interests, is extended so as to include the interests of the company's creditors as a whole as well as those of its shareholders. Where the company's interests have to be understood in that extended sense, it will be a breach of the directors' duty to the company for them to act in disregard of the creditors' interests".

[39] This paragraph encompasses the core of the rule in **West Mercia**. Once a company is insolvent or bordering on insolvency, the interests of the company for the purposes of the director's fiduciary duty are extended to include the interests of the company's creditors as a whole. Naturally, this further extension is a recognition that for *some purposes*, the interests of the company are to be regarded as including the interests of a third party that is distinct from the company as a corporate entity. Lord Reed explained the distinction as follows:

> "77 It is important to understand that the rule in West Mercia does not create any new duty: it merely adjusts the long-established fiduciary duty to act in good faith in the interests of the company. Where the rule applies, the way

> in which the company's interests are understood, for the purposes of that duty, is extended so as to encompass the interests of the general body of creditors as well as the interests of the general body of shareholders. That reflects a recognition that the traditional identification of the interests of the company with those of its shareholders, although satisfactory when the company is financially stable, needs to be widened when insolvency is imminent. The interests of the creditors as a whole should then also be taken into account and given appropriate weight, as explained in para 81 below. If insolvent liquidation or administration is unavoidable, the interests of the shareholders drop out of the picture, and the company's interests can be treated as equivalent to those of the creditors alone."

[40] The company's interests, for the purposes of the rule in **West Mercia**, is therefore extended to include the interests of the general body of creditors. Clearly, this is not to say that for every purpose the company's interest is to be regarded as including those of the general body of creditors. This applies only where the rule in **West Mercia** is engaged. The interests of the general body of creditors are protected by the rule in **West Mercia**. Where the rule in **West Mercia** applies, the interests of the general body of creditors are to be regarded as the same as the interests of the company. The duty is owed to the company, and when it is breached, the interests of the company are affected. This is an important aspect of the rule of **West Mercia**, because without it the rule would not exist at all. The recognition that the interests of the company are the same as the interests of the general body of creditors is a *sine qua non* of the existence of the rule of **West Mercia**.

[41] Lord Briggs in **Sequana** made clear at para [139] that of the two strands in the reasoning in the **Salomon** case, namely, the company as a separate entity with its own interests and responsibilities and the company as an abstract equivalent of its shareholders, it is the first which has clearly prevailed over time. When a director breaches the rule in **West Mercia** and the company seeks compensation for any resulting loss, the question arises as to whether, for the purpose of ascertaining the scope of that loss, one reverts back to the traditional principle that the company is a separate entity reflecting the orthodox view in **Salomon**, or the wider approach recognised in **Sequana** that where the rule in **West Mercia** applies, the directors

fiduciary duty is owed to the company, rather than a free-standing duty of its own as was recognised by Lord Briggs in **Sequana** at para [205].

[42] Lord Sales, dissenting, in **Stanford** explained at para [96] that corporate personality serves a representative function in that a company is not purely an abstraction, but stands for the interests which corporate personality is there to represent and protect. This means that a company has its own responsibilities separate from those of its shareholders which: (1) means that it makes no difference to external parties dealing with a company, who in ordinary circumstances just deal with it as a separate person; and (2) does affect those managing the company's affairs, by delineating the content of their duty to act in the interests of the company. Lord Sales continued at para [97] that for directors the usual position is that their duty to the company as a person means that they have to act in the interests of the shareholders as a general body but that when it becomes clear that the company is hopelessly insolvent with no light at the end of the tunnel, so that it is inevitable that it will have to go into liquidation, the directors' duty to the company means that they have to act in the interests of the company's creditors as a general body.

[43] Lord Sales explained at para [103] that the company, as an artificial legal entity, represents underlying economic interests and its interests are taken to be informed by those interests. He continued that in ordinary circumstances, the interests are those of the present and future members of the company and that the company's interests were traditionally seen as those of its shareholders, not its creditors. However, Lord Sales further explained that the law has moved on from that traditional position in relation to a company which is hopelessly insolvent and that:

> "105 The company's corporate personality continues during the liquidation process and serves a new function, to protect the interests of the creditors entitled to protection under the statutory scheme. One may debate the extent to which a liquidator's duties are owed to the company itself or to those entitled to benefit under the statutory scheme. What is important for present purposes, however, is that there is no significant difference between these options. 'The liquidator is not a trustee for individual creditors but rather an agent for the company in much the same position as a director and with statutory duties which may be enforced by application to the court.

> His duty is owed to the company and to the creditors as a class, but he does not in general owe any duty to an individual creditor' (Goode on Principles of Corporate Insolvency Law, 5th ed (2018), p 181, para 5-03, omitting footnotes). Once the company enters into insolvent liquidation and directors are replaced by a liquidator as the manager of the company's affairs and assets, the liquidator has a duty to the company and to those whose interests the company exists to promote, the practical content of which is that he has to act in the interests of the company's creditors as a general body (i e, again, fairly and without undue favouritism): In re Longmeade Ltd [2016] Bus LR 506. As Snowden J (as he then was) pointed out in that case, at para 52, 'Liquidation is a class remedy to be conducted in the best interests of the general body of creditors as a whole'; and, at para 66, this means that when taking a decision, for example, to commence proceedings in the name of the company 'the liquidators should act in what they believe to be the best interests of the insolvent company and all those who have an interest in its estate', which is to say the unsecured creditors and (if there is a surplus) the contributories.
>
> …
>
> 107 Therefore, in my view, it emerges that a company has representative responsibilities of its own in relation to certain persons who are affected by the management of its affairs and that the concept of "the company", and the corporate personality which corresponds with that concept, serve the function of ensuring that those responsibilities are fulfilled. So far as that is concerned, as Lord Briggs JSC emphasised in both Stanford International Bank (PC) and Sequana and Lord Reed PSC emphasised in Sequana, a fundamental change occurs as regards those responsibilities when a company is on the verge of, or enters, insolvent liquidation."

[44] I agree with Lord Sales that in the context of insolvency, where the rule in **West Mercia** applies, the principle of separate legal personality serves a new function, that is, to protect the interests of the creditors entitled to the protection that the rule provides.

The appropriate remedy and the nature of the loss

[45] The more controversial issue in **West Mercia** was the remedy granted by the Court of Appeal. Two fundamental questions arise. First, whether the remedy granted in **West Mercia** was based on the particular facts of that case; and second, whether the remedy granted was generally for the breach of the rule in **West Mercia**. If the answer to the first question is no, then the question of principle arises as to what the

nature of the relief to be granted when a director is found to have breached the rule in **West Mercia** and whether an appropriate remedy is repayment by the director of the sum so paid because of the breach of his fiduciary duty to the company.

[46] Throughout the judgment of Dillon LJ, the fact that Mr. Dodd benefited indirectly from the payment of the £4,000.00 looms large: (1) "The question [the county court judge] had to decide was a question concerning **fraudulent preference and misfeasance** arising in relation to the liquidation of a company …" (at p 251); (2) "The plain and obvious intention of that was to reduce the overdraft of the Dodd company which Mr. Dodd had personally guaranteed" (at p 252); (3) "Accordingly … the liquidator of the West Mercia company applied … for a declaration that **Mr. Dodd was guilty of misfeasance and breach of trust in relation to the West Mercia company** in obtaining and transferring the £4,000.00 to the Dodd company on 21st May 1984. The notice of motion asked also for **an order for repayment of that sum** with interest at 12% per annum from 21 May 1984" (at p. 252). Dillon LJ stated expressly at p 252 that (4):

> "To my mind it is quite clear that **there was a fraudulent preference of the Dodd company.** It follows that t**here was misfeasance on the part of Mr. Dodd** as a director who owed a fiduciary duty to the West Mercia company in making that transfer by way of **fraudulent preference**: see the decision of this court in Re Washington Diamond Mining Co [1893] 3 Ch 95esp at 115 per Kay LJ."

[47] Dillon LJ continued: (5) "Mr. Dodd had, **in fraud of the creditors of the company**, made the transfer to the Dodd company's account **for his own sole benefit** in relieving his own personal liability under his guarantee" (at p. 252); and (6) "Mr. Dodd was guilty of breach of duty when, for his own purposes, he caused the £4,000.00 to be transferred in disregard of the interests of the general creditors of this insolvent company" (at p. 253).

[48] Dillon LJ then turned to the question of what financial relief ought to be granted against Mr. Dodd for breach of the fiduciary duty to the company, answering it at p. 253 as follows:

> "Prima facie the relief to be granted where money of the company has been **misapplied by a director for his own ends** is an order that he repay that money with interest, as in Re Washington Diamond Mining Co. The section in question, however, s 333 of the Companies Act 1948, provides that the court may order the delinquent director to repay or restore the money, with interest at such rate as the court thinks fit, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication as the court thinks fit. The court has a discretion over the matter of relief, and it is permissible for the delinquent director to submit that the wind should be tempered because, for instance, full repayment would produce a windfall to third parties, or, alternatively, because it would involve money going round in a circle or passing through the hands of someone else whose position is equally tainted." (emphasis added)

[49] It seems clear that in framing the relief to be granted, Dillon LJ had in mind the misapplication by a director of the money of the company "**for his down ends**" and that the relief to be granted was that the director is to repay the company that money with interest. He cited for that proposition the decision of the Court of Appeal of England and Wales in **Re Washington Diamond Mining Co**[8] that concerned the payment of fees by two directors of a company to themselves with a view to giving themselves a preference over creditors of a company at a time when that company was insolvent. That decision dealt with whether the payment was a preference under section 164 of the Companies Act 1862. It did not concern the relief to be granted where a director breaches the rule in **West Mercia**.

[50] In **West Mercia**, counsel for Mr. Dodd submitted that the misapplication of £4,000.00 of West Mercia Ltd's money for his own benefit had not caused any loss either to the company or, through the company and its liquidator, to any of the creditors of the company. Dillon LJ rejected the proposed calculation that informed that submission stating at p. 254 [explaining] that that approach did not consider the costs and expense of the winding up which included: all the necessary expenses of realisation, the liquidator's remuneration, and the costs of litigation. Responding specifically to

[8] [1893] Ch 95.

the issue of loss to the company, West Mercia Ltd, Dillon LJ explained at p. 254 as follows:

> "I take the view, notwithstanding that the judge accepted the submission of counsel for Mr. Dodd that no loss to any creditor had been shown, that counsel, on whose client the onus lay, has failed to establish that there is no loss to be met by his client. Indeed, it would be surprising if there were no loss where there was such a blatant misfeasance."

[51] Dillon LJ did not identify the loss for which Mr. Dodd was to repay the sum of £4,000.00 to West Mercia Ltd. However, he did observe that whatever loss might have been occasioned it was the result of the "blatant misfeasance" of Mr. Dodd. He then ordered at p 255 that:

> "In my judgment the appropriate course of administration in the present case is to order Mr Dodd to repay the £4,000.00 with interest and to direct that in the distribution of the assets of the West Mercia company to unsecured creditors the debt due from the West Mercia company to the Dodd company is to be taken as notionally increased by £4,000.00 to what it would have been **if there had not been a fraudulent preference**, and then any dividend attributable to the extra £4,000.00 thus added back to the debt of the Dodd company is to be recouped to Mr. Dodd rather than being paid to the Dodd company. That, as I see it, is a rough and ready way of achieving justice on both sides."

[52] It seems to me that the remedy granted by Dillon LJ in **West Mercia** was based on the breach of the rule in **West Mercia**. Although the action of the director in making the payment for his own benefit which amounted to what was called a "blatant misfeasance" loomed large in the decision of Dillon LJ, it cannot be said that when properly read in context that that feature was the sole basis or an important factor that informed his reasoning in respect of the remedy granted. The decision therefore accepts that a repayment of any sums paid in breach of the rule in **West Mercia** is an appropriate form of relief.

[53] Lord Reed in explaining the interaction of the rule in **West Mercia** and section 214 of the UK Insolvency Act (wrongful trading) stated that:

> "96 On the approach which I have adopted, the rule in West Mercia is merely a modification of the directors' fiduciary duty to the company, widening the scope of the interests which are taken into account when

considering the company's interests, so as to include creditors' interests as well as shareholders'. Where those interests conflict, a balance has to be struck between them, reflecting their respective weight in the light of the gravity of the company's financial difficulties. So understood, the directors" fiduciary duty to the company, as so modified, reflects the reality of the economic interests in the company: that is to say, the fact that the interests of creditors acquire a discrete significance from those of shareholders, and require separate consideration, once the company's insolvency is imminent, or its insolvent liquidation or administration becomes probable."

[54] In examining the interaction between the rule in **West Mercia** and section 239 of the UK Insolvency Act (preferences), Lord Reed stated that:

> "102 It was argued on behalf of the defendants that the 'creditor duty' for which the claimants argued not only could but had in fact been used to reverse preferences in situations in which section 239 did not apply, thereby enabling the limitations inherent in section 239 to be circumvented. This disturbed the balance achieved by Parliament between the integrity of the pari passu principle, which section 239 protects, and the security of transactions. If directors were ordered to repay the company, that also resulted in over-compensation, since the company recovered despite not suffering any loss (since the debt that was paid preferentially was properly due). Furthermore, the fact that the company suffered no loss as the result of a preferential payment, whereas the creditors as a whole did suffer a loss, demonstrated that the quasi-proprietary rationale for equating the company with its creditors, as suggested in Kinsela and accepted in West Mercia, was flawed.
>
> 103 These submissions raise two important points, which are essentially opposite sides of the same coin. First, if a pecuniary remedy for a breach of the fiduciary duty is designed to compensate the company for a loss which it has suffered as a result of the breach, then it is argued that no such pecuniary remedy can be granted to the company in respect of preferential payments, since they do not cause the company (as distinct from the general body of creditors) to suffer any loss. If, on the other hand, a pecuniary remedy for a breach of the fiduciary duty is available to the company even where it has not suffered any loss, then it is argued that no such remedy should be given in respect of preferential payments where a remedy could not be given under section 239, in order to avoid undermining that provision.
>
> 104 Both points have been the subject of some consideration in the case law. As explained in para 35 above, West Mercia was itself concerned with proceedings brought by a liquidator against a director who had authorised a preferential payment, in circumstances where a claim against the recipient of the payment under the predecessor of section 239 would not

have been worthwhile. The relief given against the director was not simply an order that he repay the amount of the preference, since such an order would have left the company better off than if no breach of duty had occurred. That was because, if there had been no breach of duty, while the company's assets would have included the amount of the payment, its liabilities would also have included the amount of the debt due to the recipient of the payment. Accordingly, while the director was ordered to repay the amount which he had misapplied, with interest, the Court of Appeal also ordered that the debt which had been discharged by the payment should be included in the amount of the company's liabilities for the purpose of calculating the distribution in the company's winding up, with any dividend attributable to that debt being paid to the director. The overall effect was to produce a similar result for the unsecured creditors as would have obtained if the preferential payment had not been made or if it had been set aside as a preference, with the director being treated in the same way as if he had personally paid the debt and been subrogated to the creditor's right against the company.

105 My provisional view is that the court was correct in taking that approach to the question of relief. In order to obtain a pecuniary remedy, it was not necessary for the company to have suffered a loss in the conventional, balance sheet, sense. The funds available to the company to meet the claims of the general body of creditors were depleted as a result of the director's breach of his fiduciary duty. The court granted an equitable remedy, based on the restoration of the misapplied monies to the company so as to reconstitute its assets as they ought to have been. By doing so, and treating the debt as subsisting for the benefit of the director, the court achieved the equivalent, as nearly as possible, of the director's performance of his fiduciary duty to the company."

[55] In examining the remedy that the Court of Appeal fashioned in **West Mercia**, Lady Arden stated that:

"402 Dillon LJ went on to order relief against Mr Dodd on the basis that he was liable for breach of duty and that he would be liable only for the loss to the transferring company. Accordingly he ordered Mr Dodd to compensate the company for the £4,000.00 but that dividends to creditors should be calculated on the basis that, for the purposes of the proof of debts, the debt owed by the subsidiary company to its parent company was not reduced by the amount which Mr Dodd had to repay and that any amount that would be distributable by way of dividend to unsecured creditors in respect of that part of the debt due to the parent company should be paid instead to Mr Dodd. In my judgment, there is nothing novel in this. Courts of equity granting relief on claims for misfeasance can mould remedies in an appropriate way to meet the circumstances of the case: see, for example, In re VGM Holdings Ltd [1942] Ch 235. The transfer did not benefit his

> company and there was no good corporate reason for making it. In those circumstances, the transfer was in breach of his duty to use his powers for a proper purpose. Mr Dodd would be liable to compensate the company and restore it to its previous position (see AIB Group (UK) plc v Mark Redler & Co Solicitors [2015] AC 1503)."

[56] Lady Arden expressly agreed at para [327] with the provisional views of Lord Reed at para [105].

[57] Once one accepts that the basis of the decision in **West Mercia** is the payment by the director to the creditor at a time when the company is insolvent or insolvency is imminent, one cannot but also accept that the remedy ordered by the Court of Appeal, namely, the repayment by Mr. Dodd to the company of the amount that was paid to the company's creditor in breach of the rule in **West Mercia** was ordered even though the payment was balance sheet neutral. In other words, the remedy ordered by the Court of Appeal was made notwithstanding that the payment was balance sheet neutral. Lord Reed in **Sequana** at para [103] captures the essence of the issue that needs to be answered in this appeal – if a pecuniary remedy for a breach of the fiduciary duty is designed to compensate the company for a loss which it has suffered as a result of the breach, then it is argued that no such pecuniary remedy can be granted to the company in respect of preferential payments, since they do not cause the company (as distinct from the general body of creditors) to suffer any loss. In my view, the answer to this question depends on the nature of the "loss" that is occasioned and by whom. It is not disputed that any loss must be that of the company to whom the duty (as reflected in the rule in **West Mercia**) is owed. The question is whether the "loss" suffered by the general body of creditors can be equated to "loss" suffered by the company for the purposes of the breach of the rule in **West Mercia**.

[58] The issue as I see it is two sides of the same coin. On one side, for the purposes of the rule of **West Mercia**, the interests of the company must include the interests of the general body of creditors. Company directors must ensure that they act in the best interests of the company and this requires them, when the company is insolvent or insolvency is imminent, to consider the interests of the general body of creditors.

What purpose is therefore served by the rule in **West Mercia**? In my view, it is to ensure that the assets of company (whose interests the rule is designed to protect) are preserved for the general body of creditors during insolvency. In other words, the general body of creditors should not suffer any financial loss by the actions of directors when the company is insolvent, or insolvency is imminent. How is that loss to be measured when arguably the loss is essentially that of the general body of creditors and not the company as a separate legal personality? It must therefore mean that, for the purposes of determining the loss caused by a breach of the rule in **West Mercia**, any loss to the general body of creditors must be equated with that of the company. If this is not the appropriate basis for measuring the loss to the company, the rule in **West Mercia** would be a toothless dog, having no bite. Directors would act with impunity in breach of the rule in **West Mercia** comforted in the knowledge that once the transaction is balance sheet neutral, the company would suffer no loss and consequently the directors will not be liable at all for any such breach.

[59] The paragraph above represents my considered view on the issue raised in this appeal. It has support from the provisional view of Lord Reed in **Sequana** at para [105] when he states that his provisional view is that the Court of Appeal in **West Mercia** was correct in taking that approach to the question of relief. Lord Reed explained that to obtain a pecuniary remedy, it was not necessary for the company to have suffered a loss in the conventional, balance sheet sense. He continued that: (1) funds available to the company to meet the claims of the general body of creditors were depleted as a result of the director's breach of his fiduciary duty; (2) the court granted an equitable remedy, based on the restoration of the misapplied monies to the company so as to reconstitute its assets as they ought to have been; and (3) by doing so, and treating the debt as subsisting for the benefit of the director, the court achieved the equivalent, as nearly as possible, of the director's performance of his fiduciary duty to the company. This reasoning reflects the basic premise accepted above that any loss to the general body of creditors by reason of the breach of the

rule in **West Mercia** is to be treated as a loss to the company. As noted above, Lady Arden expressly approved of Lord Reed's provisional views on this issue.

[60] In **Bilta (UK) Ltd (in liquidation) and others v Nazir and others (No 2)**[9], the UKSC had to consider whether a company is barred by the doctrine of illegality from suing directors of that company (who involve it in a fraudulent transaction) and their accessories for losses caused by their breach of fiduciary duty. In that decision, the liquidators through the company claimed damages for conspiracy or equitable compensation against the directors for breach of fiduciary duty. Lord Toulson and Lord Hodge, in a joint judgment, explained that:

> "126 Instead, the protection which the law gives to the creditors of an insolvent company while it remains under the directors' management is through the medium of the directors' fiduciary duty to the company, whose interests are not to be treated as synonymous with those of the shareholders but rather as embracing those of the creditors.
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> 127 Such protection would be empty if it could not be enforced. To give effect to it, this action is brought by the liquidators in the name of the company to recover, for the benefit of the creditors, the loss caused to the company by the directors' breach of their fiduciary duty."

[61] The next question arising in this appeal is whether the position I have accepted at para [58] above concerning loss arising from a breach of the rule in **West Mercia** is contrary to principle or existing authority. The remedy of compensation for loss granted by the Court of Appeal in **West Mercia** represents the appropriate order for a breach by a director of the rule in **West Mercia**. As just explained, given the nature of the rule in **West Mercia**, for the purposes of determining the appropriate loss to the company it is the corresponding loss to the general body of creditors that needs to be assessed when determining the loss for the purposes of the compensatory remedy for which the director is liable.

[9] [2016] AC 1.

The decision of the UKSC in AIB

[62] The leading decision on the nature of equitable compensation for breach of fiduciary duty is the decision of the UKSC in **AIB**. As Lord Toulson observed at para [1], **AIB** concerned the remedy available to the appellant bank against the respondent, a firm of solicitors, for breach of the solicitors' custodial duties in respect of money entrusted to them for the purpose of completing a loan which was to be secured by a first charge over the borrowers' property. AIB Group (UK) plc (**AIB**) agreed to advance the sum of £3.3m to the borrowers for the re-mortgage of their property. The property was the subject of a first legal charge in favour of Barclays Bank pls (**Barclays**) in respect of approximately £1.5m secured by a first legal charge on two accounts. It was a condition of the loan that the existing mortgage be redeemed on or before completion. Mark Redler & Co Solicitors, the solicitors for the borrowers, received in error a redemption figure in respect of only one account which they took to be the total figure. That sum was discharged, leaving an outstanding indebtedness of £309,000.00 and paid out the balance to the borrowers. Barclays refused to release its first charge unless the outstanding debt was paid in full. The borrowers defaulted and Barclays sold the property for £1.2m of which AIB received a sum of approximately £867,697.00. The claimant brought proceedings to recover from the defendants the full amount of the loan, less the amount recovered by the sale, claiming relief by way of reconstitution of the fund paid away in breach of trust and of fiduciary duty, equitable compensation for such breaches and damages for breach of contract and negligence.

[63] Lord Toulson noted at para [8] that the issue is how much the bank is entitled to recover from the solicitors. AIB claimed that it was entitled to the full amount of its loan less the amount recovered by it but the solicitors contended that their liability was limited to the amount by which the bank suffered loss by comparison with its position if the solicitors had done as they should, which was to have paid Barclays the full amount of the Barclays debt so as to redeem the Barclays charge. Lord Toulson continued that the difference, leaving interest aside, was between £2.5m and £275,000.00 in round figures. The trial judge held that *prima facie* the bank was

entitled to reconstitution of the trust fund by repayment of the amount wrongly paid away, namely, the sum of £273,777.00 plus interest. The Court of Appeal, applying the reasoning of the House of Lords in **Target Holdings Ltd v Redferns**,[10] upheld the decision of the trial judge on the basis that where the breach of trust occurred in the context of a commercial transaction equitable principles of compensation recognise what loss the beneficiary has actually suffered from the breach of trust and to base the compensation recoverable on a proper causal connection between the breach and the eventual loss.

[64] Lord Toulson stated that the correct position was that:

> "64 All agree that the basic right of a beneficiary is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law. Where there has been a breach of that duty, the basic purpose of any remedy will be either to put the beneficiary in the same position as if the breach had not occurred or to vest in the beneficiary any profit which the trustee may have made by reason of the breach (and which ought therefore properly to be held on behalf of the beneficiary). Placing the beneficiary in the same position as he would have been in but for the breach may involve restoring the value of something lost by the breach or making good financial damage caused by the breach. But a monetary award which reflected neither loss caused nor profit gained by the wrongdoer would be penal".

[65] Lord Reed, after citing a passage of Lord Browne-Wilkinson in **Target Holdings** (at p 436), stated that:

> "105 This passage contains a number of ideas. The first is that 'the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach.' That is a broad proposition, which leaves open what precisely is meant by 'loss', and how it is assessed. As McLachlin J explained in Canson Enterprises, the basic obligation of a defaulting trustee is to restore the trust fund to the position it would have been in but for the default. In relation to the breach of a fiduciary duty, her Ladyship said (in the passage cited at para 89, also cited by Lord Browne-Wilkinson with approval at a later point in his speech) that, by analogy, compensation for breach of such a duty attempts to restore to the plaintiff what has been lost as a result of the breach. Lord Browne-Wilkinson's dictum should in my view be

[10] [1996] AC 421.

> understood in that sense: the 'loss' is what the beneficiary has been deprived of as a result of the breach."

[66] Lord Reed concluded that:

> "141 In these circumstances, applying the approach to the assessment of equitable compensation which I have explained, it appears to me that the loss to the trust estate as a result of Redler's breach of trust proved to be £273,777.42: that amount proved to be the pecuniary value of the difference between a first ranking security and one which was postponed to Barclays'. That was also the loss to AIB, who were absolutely entitled to the trust estate. The trust no longer being on foot, the appropriate order is for Redler to pay AIB £273,777.42 plus interest from 2011."

[67] In my view, nothing in the decision of the UKSC in **AIB** contradicts or conflicts with the decision of the Court of Appeal in **West Mercia**. Context is everything. Once it is understood that "loss" to the general body of creditors is to be equated to loss to the company for the purpose of a breach of the rule in **West Mercia**, then the concerns of Lord Legatt at para [72] in **Stanford** immediately disappears. Lord Reed at para [105] in **AIB** states succinctly that the basic equitable principle applicable to breach of trust is that the beneficiary is entitled to be compensated for any loss he would not have suffered but for the breach "leaves open what precisely is meant by "loss", and how it is assessed". This is precisely what has been answered above and, in my view, ensures that the approach adopted in this appeal and in **West Mercia** reflects and is in sync with existing principles concerning equitable compensation.

The decision of the UKSC in Standford

[68] The issue with which we are concerned here was given extensive consideration by Lord Legatt and Lord Sales (dissenting) in **Stanford**. Both judgments reflect two opposing views on this issue. Lord Legatt accepts the traditional view of **West Mercia** which I have explained above does not represent a proper reading of the loss for the purposes of the rule in **West Mercia**. The outcome in **Stanfor**d itself, at first blush, seems to accept the traditional view as espoused by the respondent in this appeal.

[69] In **Stanford**, the claim by Stanford International Bank (**SIB**) was against the respondent bank, HSBC Bank plc (**HSBC**), for breach of the *Quincecare* duty when

the HSBC made payments totaling £116m out of the bank accounts of the SIB prior to insolvency. HSBC applied to strike out the claim arguing that if SIB were to succeed at a trial in establishing that HSBC owed such a *Quincecare* duty to SIB of which HSBC was in breach, SIB could not show that the breach caused SIB to suffer any loss. This was because the payments of £116m out of SIB's accounts reduced SIB's liabilities by an equal amount and left its net asset position unchanged. In other words, the payments were balance sheet neutral. The application to strike out was refused by the trial judge but that decision was overturned by the Court of Appeal of England and Wales. SIB appealed to the UKSC.

[70] The sole issue for the UKSC was whether, assuming HSBC did owe SIB the *Quincecare* duty and was in breach of that duty, the breach gave rise to any recoverable loss by SIB. Lady Rose, who wrote the judgment for the majority of the UKSC, held that the disputed payments made allegedly in breach of the *Quincecare* duty did not cause SIB any monetary or pecuniary loss (at para [26]). Lady Rose at para [31] agreed with the Court of Appeal that the claim must be struck out, explaining that SIB had not suffered the loss of a chance that had any pecuniary value to it and hence there was nothing recoverable on its pleaded case. Lady Rose stated at para [25] that since the equivalent debt would be extinguished on winding up, there was no recoverable loss. Lady Rose explained that:

> "25 Assuming that all those customers then share pari passu in the liquidation, they will all have those debts "discharged" for the same dividend as part of the same winding up procedure. In the counterfactual world where there is an extra £116m for the liquidators to distribute, one might assume that all customers will get a higher dividend, say 12 pence in the pound rather than the five pence in the pound that the late customers will ultimately receive in the real world. That would mean that a higher percentage of the debt that was originally owed to each customer will be "discharged" when the company is dissolved. But the "chance" of being able to discharge a debt owed to an early customer by paying them 12 pence instead of the 100 they were in fact paid, is matched by the "risk" of having to pay the late customers 12 instead of five to "discharge" the debt owed to them on dissolution. The chance must, in the circumstances, be quantified as exactly the same amount as that risk. No additional customer indebtedness is paid off; exactly the same amount of indebtedness is in effect extinguished "for free" on the company's dissolution. The chance that is lost to SIB as a result of HSBC's breach is not, therefore, a chance either to pay

> more money overall to the pool of indistinguishable customers or a chance to "discharge" more of their indebtedness for free."

[71] In my respectful view, the loss to the general body of creditors is in not having the £116m to share among them all in the liquidation. Without the payment of £116m, the general body of creditors would get 12 pence in the pound rather than 5 pence in the pound because of the payment of £116m made to those customers. The loss to the general body is the therefore 7 pence in the pound. In all such cases, an equivalent amount of indebtedness is paid off that corresponds to the loss to the general body of creditors. The essential question is whether in the circumstances it is correct that the bank should account to the creditors for that loss. In the context of the decision in **Stanford**, the wider considerations at play in the decision in **West Mercia** and in respect of the application of the rule in **West Mercia** were not material or relevant.

[72] Two points are immediately worthy of note concerning the decision of the UKSC in **Stanford**. This decision did not concern the breach of the rule in **West Mercia** since it was not concerned with any breach of a fiduciary duty of the company directors to act in the best interests of the general body of creditors when the company is insolvent or when insolvency is imminent. Second, it related specifically to a breach by the bank of its duty to refuse to comply with a payment instruction in circumstances where the bank is on notice that the instruction may be part of a fraud on the customer (the "*Quincecare*" duty).

[73] It is accepted that the decision of the UKSC in **Stanford** at first blush potentially undermines the very rationale for the remedy granted in **West Mercia**. However, the decision of the UKSC in **Stanford** can be distinguished from **West Mercia** and the facts underlying this appeal because it did not involve a breach of the rule in **West Mercia** which, as argued above, involves a broader understanding of loss to the company as including loss suffered by the general body of creditors as a result of the breach by the directors of their duty to the company to have regard to the interest of the general body of creditors when the company is insolvent or when insolvency is

imminent. In **Stanford**, the breach of the *Quincecare* duty of care, while it resulted in loss to the creditors, it did not involve a breach of any fiduciary duty owed by the directors to the company but involved a breach by a third party, the bank (HSBC), of the general duty of care owed by banks to interpret, ascertain and act in accordance with its customer's instructions as was stated at para [97] of the decision of the UKSC in **Philipp v Barclays Bank UK plc**.[11] The financial loss to the general body of creditors could not be equated to that of the company because the fiduciary duty in question is not a duty that is owed to the company in the manner contemplated by the rule in **West Mercia**.

[74] Lady Rose noted at para [33] that she does not accept that a decision that no recoverable loss is suffered by SIB undermines the ability of the court of equity to identify a case of misfeasance and fashion an appropriate remedy, as the Court of Appeal did in **West Mercia**. However, if Lady Rose had appreciated: first, that the remedy granted by the Court of Appeal in **West Mercia** was not limited to the "misfeasance" of the director, and, second, that the recoverable loss for breach of the rule in **West Mercia** is the pecuniary loss suffered by the general body of creditors, her statement made at para [33] would arguably have been different.

The concurring opinion of Lord Leggatt in Stanford

[75] In **Stanford**, Lord Leggatt, concurring, stated that:

> "58 Counsel for SIB submitted that the decision of the Court of Appeal in West Mercia Safetywear Ltd v Dodd (1987) 4 BCC 30 shows that a payment can cause loss to an insolvent company even though it discharges a debt owed by the company. They then sought to extrapolate from this to the conclusion that the disputed payments (somehow) caused loss to SIB. Had such a step formed part of its reasoning, the Court of Appeal in West Mercia would in my view have been in error. But I think it clear from the judgment in that case that the Court of Appeal made no such error."

[76] After examining the judgment of Dillon LJ in **West Mercia**, Lord Legatt explained that:

[11] [2023] 3 WLR 284.

> “63 In the West Mercia case counsel for Mr Dodd advanced an argument that, as summarised by Dillon LJ at p 33, the payment of the £4,000 ‘has not caused any loss either to the company or, through the company and its liquidator, to any of the creditors of the company’. This was not an argument that no loss had been caused because the payment discharged a valid debt. While the fact that the payment discharged a valid debt meant that the payment had not caused any loss to the company, or to its creditors collectively, it plainly did not mean that the payment had not caused loss to any of the creditors of the company. On the contrary, if the company lacked sufficient assets to pay all its debts, the payment made was clearly capable of making creditors other than the parent company worse off, as it reduced the amount available to distribute in the liquidation. The argument made on Mr Dodd's behalf was a different one. What counsel for Mr Dodd sought to show was that, on the particular facts of the case, the payment of £4,000.00 made to the parent company would not affect the sums distributed in the liquidation. Counsel relied on an estimated statement of affairs to argue that, on the basis that the £4,000.00 ought to be included in the assets available for distribution as its transfer was a fraudulent preference, the amount payable to the parent company as a dividend would exceed £4,000.00. The £4,000.00 could therefore be recouped by deducting it from the dividend ultimately paid to the parent company, and none of the creditors would suffer any loss. So there was no need to require Mr Dodd to replace this sum.
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> 64 Dillon LJ did not accept that this contention had been made out on the evidence, principally because the estimated statement of affairs did not take account of the costs of the winding up (including the irrecoverable element of the costs of suing Mr Dodd). However, the proviso to the order made by the Court of Appeal ensured that, to the extent that the company had assets which could be used to pay its unsecured creditors, Mr Dodds would not be disadvantaged as he would in that event get back a pro rata share of the £4,000.00 that he was ordered to restore.”

[77] After examining the decision of the UKSC in **AIB**, Lord Legatt stated that:

> “72 It is open to question whether the remedial approach adopted in the West Mercia line of cases can be reconciled with this decision, as pointed out in a helpful article: Kristin van Zwieten, ‘Director Liability in Insolvency and its Vicinity’ (2018) 38 OJLS 382, 403. It is true that in the West Mercia line of cases the potential objection to granting equitable relief is not that loss would have been suffered anyway but that the misapplication of funds did not cause any loss to the company in the first place. But it is hard to see why generally this distinction should make a difference given that, if the value of the trust fund has not been diminished, no payment is required to restore its value. Generally speaking, there is no justification in terms of legal policy for ordering a defaulting trustee or other fiduciary to pay money

to the trust fund which reflects neither any loss caused to the trust fund nor any gain made by the trustee. To do so, as Lord Toulson JSC observed in AIB at para 64, would be penal.

73 It might, however, be said that the position is different where a transfer of company assets made by a director is an unlawful preference. In such a case it is arguably not sufficient to say that no remedy is required because the value of the fund has not been diminished. The policy of English law, embodied in section 239 of the Insolvency Act 1986, is that where a company has given a preference falling within the scope of that provision the position of the company ought to be restored to what it would have been if the company had not given that preference. As discussed earlier, it is no answer to say that nothing needs to be done to achieve this aim as the transaction has not diminished the company's assets. The point of this element of the insolvency legislation is not to provide a means by which the company can recover compensation for loss; it is to enable a liquidator to reverse transactions which, even though they caused no loss to the company, have in the eyes of the law unjustly enriched the preferred creditor at the expense of the other creditors by depleting the pool of assets which ought to be available to distribute equally in the winding up.

74 It is consistent with this policy of redistribution to require a director who, in breach of fiduciary duty, has caused the company to give an unlawful preference to restore the company's position to what it would have been if the transaction had not taken place. That is what was done in the West Mercia case 4 BCC 30 itself. The unlawful preference could not have been reversed in that case by ordering the parent company to return the money, as it was itself insolvent and had no assets available to repay the £4,000: see p 32. But Mr Dodd was ordered to repay the money himself and stand in place of the parent company as a creditor of the subsidiary. It could be said that this fulfilled the basic remedial aim of putting the company into the position it would have been in if the breach of fiduciary duty had not occurred. More generally, it seems just to put the risk that the transfer cannot or will not be restored by the recipient on the person whose breach of fiduciary duty caused the unlawful preference to be given.

75 This rationale would not apply, however, in a case such as HLC Environmental Projects where the payment made in breach of the director's duty was not an unlawful preference. Whether a payment made in the period before a company goes into insolvent liquidation which advantages one creditor at the expense of others ought to be reversed is a question of policy answered by the rules of the applicable insolvency regime. It is the function of those rules to determine which assets, including assets disposed of before the commencement of winding up, should be available to be allocated through the liquidation process and which should not. As noted earlier, this point was central to the reasoning of the Privy Council in the earlier Stanford appeal. It is hard to see how, in the absence of loss to the

company or gain to the director, a director who causes a payment to be made to a particular creditor which does not meet the criteria for an unlawful preference and which the creditor is entitled to keep could properly be held liable to repay the money. Requiring the director to repay the money in such a case would cut across the distribution of assets provided for by the insolvency regime. It would also impose on the director a liability for which he or she (despite not having personally received a benefit) would not even in principle be entitled to an indemnity from the person who received the money. That would not be just."

[78] In respect of loss and the relevance of common law damages, Lord Legatt stated that:

> **"No relevance to common law damages**
> 76 It is unnecessary to form any concluded view on this point, however, in order to decide this appeal. This is for the straightforward reason that the claim against HSBC in this case is not a claim against a director for breach of a trustee-like fiduciary duty owed to the company in managing its assets. This is not a case in which any fiduciary duty is alleged. It is a claim at common law for damages for breach of a duty of care allegedly owed in contract and tort. Equitable remedies of accounting or equitable compensation are not available and have not been claimed by SIB. It is therefore unnecessary to decide whether the remedy granted in the West Mercia case was justified in the light of this court's subsequent decision in the AIB case and whether, if so, the justification is limited to cases such as West Mercia where the transaction was an unlawful preference.
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> 77 Even if there are circumstances in which a defaulting fiduciary who has misapplied trust money can properly be ordered to replace the money when no loss has been caused to the trust estate (and no gain made by the fiduciary), there is no justification for importing such an approach into a claim for damages for breach of contract or in the tort of negligence. The recent direction of travel has been in the opposite direction and has brought the principles governing the award of equitable compensation into closer alignment with the common law rules. No court or commentator, so far as I am aware, has sought to extrapolate from the law about equitable remedies for breach of fiduciary duty to suggest any dilution of the basic compensatory principle which underpins the award of damages for breach of contract and in tort.
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> 78 That compensatory principle requires a comparison to be made between the claimant's net asset position following the disputed payments and what its net asset position would have been if the payments had not been made. The aim of an award of damages is to compensate the claimant (subject to limiting principles of remoteness etc) for any net loss represented by the

difference between these amounts. Considerations of reversing unjust enrichment or reconstituting a trust fund play no part in the assessment.

The Sequana case

79 In the West Mercia case the director, Mr Dodd, was in breach of his fiduciary duty to exercise his powers as a director in the interests of the company and not in his own self-interest. The payment which he caused to be made was plainly not in the company's interest and was made “for his own sole benefit in relieving his own personal liability under his guarantee” (see p 33). The West Mercia case has, however, been viewed as authority for the existence of a more specific fiduciary duty owed by directors of a company which is insolvent to have regard to the interests of its creditors. The existence of this “creditor duty” has been affirmed by this court in BTI 2014 LLC v Sequana SA [2022] 3 WLR 709, decided since the hearing of the present appeal.

80 As explained by Lord Briggs JSC, who gave the principal judgment in the Sequana case with which Lord Kitchin JSC and Lord Hodge DPSC agreed, the duty derives from the entitlement of creditors, in the liquidation of a company, to have its assets distributed to them in accordance with the statutory scheme. Although Lord Briggs JSC used the term “creditor duty” as a convenient shorthand, he made it clear that the duty, when engaged, is owed to the company, and not to its creditors directly (see para 112), and that it is not a freestanding duty but is in truth simply an aspect of the director's fiduciary duty to act in good faith in the interests of the company (see para 205). That basic duty is modified when the entitlement of creditors to share in distributions in a liquidation is in prospect such that the directors must take the interests of creditors into account.

81 As Lord Sales JSC explains in his judgment, the abstract nature of a company as a separate legal person does not mean that a company is regarded as having interests which are independent of the interests of those who have actual or prospective entitlements to its assets. This does not detract, however, from the fundamental principle of separate corporate personality whereby the rights and obligations, assets and liabilities, and consequently also the losses and gains, of a company are in law distinct from those of the persons who have economic interests in the fortunes of the company, be they shareholders or creditors. While a company is solvent, there is likely to be a correlation between loss suffered by the company and loss suffered by its shareholders. But they are not the same loss: see e g Marex Financial Ltd v Sevilleja [2021] AC 39. Similarly, when a company is insolvent, loss suffered by the company may result in future loss to creditors of the company by affecting the amount that they will be entitled to receive in a subsequent liquidation. But loss suffered by the company and loss suffered by its creditors are different losses and, if the law is to be coherent, it is important not to blur the distinction between them.

82 Thus, part of what the Sequana case decides is that, whereas in ordinary circumstances the interests of a company are equated with the interests of its present and future members, when a company enters insolvent liquidation it is the interests of its creditors which become paramount. This point is critical in determining what the director's fiduciary duty to act in the interests of the company requires at a given time. It has no bearing, however, on whether a payment which a director causes to be made out of the company's assets in breach of this fiduciary duty gives rise to a loss to the company.

83 It would be contrary to first principles to posit that, at some (imprecise) point on a path that leads to a company going into insolvent liquidation, the nature of its legal personality changes, such that, from then on, any disposition of the company's assets is treated as a loss to the company even if it discharges a liability and so leaves the company's net asset position unchanged. There is nothing in the judgments in the Sequana case which supports such a view, and I know of no authority which supports it. I am also concerned that, as well as being contrary to legal principle, such an approach, if adopted, would introduce considerable uncertainty into an area of law where clear rules are essential. Statutory insolvency regimes invariably specify a precise period of time before a company goes into insolvent liquidation within which preferences are liable to be re-opened. There is good reason for this approach in the interests of legal certainty. I do not think that English (or Antiguan) law would be well served by creating a parallel common law regime in which, as from a date about which there would be ample scope for argument, the discharge of a debt is treated as a loss to the company.

84 If this were a case about whether, in authorising or failing to prevent the disputed payments, SIB's directors were in breach of their fiduciary duties, then (assuming that the law of Antigua is the same as English law in this respect) the Sequana case would be in point. But I cannot see that the questions addressed in that case are relevant to whether—as a matter of factual, “but for” causation—the alleged negligence of an external party (HSBC) caused SIB to suffer loss.

Conclusion

85 The short of the matter is that there are in my opinion no reasonable grounds for the claim that SIB suffered loss by making payments for which it received full value. For that reason its claim to recover (more than nominal) damages from HSBC must fail. In agreement with Lady Rose JSC, therefore, I would dismiss the appeal.”

[79] I accept immediately that the Court of Appeal in **West Mercia** did not in fact state that the remedy is payable irrespective of loss to the company. In my view, as stated

above, it all depends on the way in which loss to the company is conceptualised in the context of a breach of the rule in **West Mercia**. I agree with Lord Leggatt that the issue concerning loss in **West Mercia** was a bit more nuanced in that it was argued that the creditors suffered no loss because there were sufficient assets to satisfy the creditors. However, this assessment was based on an estimated statement of affairs, which the Court of Appeal held in **West Mercia** did not properly consider additional losses to the company, including the costs of the winding up. I also agree with Lord Leggatt that a breach by a director of the rule in **West Mercia** in paying a debt of the company does not of itself mean that the company suffers a loss. This is not however what the Court of Appeal in **West Mercia** decided. Where a financial loss is suffered by the general body of creditors, it will therefore be a loss to the company for the purposes of the principle of equitable compensation requiring the directors in breach to make good that loss by repaying that sum to the company. Where the creditors suffer no financial loss, there would be no basis for requiring the director to repay any sum to the company.

[80] With respect, I do not agree with the statement of Lord Leggatt at para [72] that it was open to question whether the remedial approach adopted in the **West Mercia** line of cases can be reconciled with the decision of the UKSC in **AIB**. Once it is accepted that the loss to the general body of creditors is to be regarded as a loss to the company for the purpose of the breach of the rule in **West Mercia**, then the basis of that argument falls away and its reasoning thereby undermined. For that same reason, the statement of Lord Leggatt that, generally speaking, there is no justification in terms of legal policy for ordering a defaulting trustee or other fiduciary to pay money to the trust fund which reflects neither any loss caused to the trust fund, nor any gain made by the trustee, cannot, in my respectful view, stand. It is simply a matter of determining whose loss is relevant for the purposes of the analysis.

[81] In principle, I agree that the court should be cautious to ensure that the common law rules do not undermine the statutory insolvency regime. However, the courts have already firmly established the rule in **West Mercia**, which was confirmed by the

UKSC in **Sequana**, creating a common law regime that sits alongside the statutory insolvency regime. In my view, the rule in **West Mercia** is wider than the statutory regime pertaining to unlawful preferences so the limitations that concern unlawful preferences cannot (and should not) be imported into the application of the rule in **West Mercia**. Once it is appreciated that the loss in question is the loss to the company, a director who causes a payment to be made to a creditor which does not meet the criteria for an unlawful preference and which the creditor is entitled to keep, can properly be held liable to repay the money (to use Lord Leggatt's words at para [75]) in accordance with remedial approach adopted in **West Mercia**. Contrary to Lord Leggatt's view at para [75], requiring the director to repay the money in such a case would not cut across the distribution of assets provided for by the insolvency regime. In my view, there is nothing unjust in imposing liability on the director a liability for a breach of the rule in **West Mercia**, irrespective of whether: (1) the director personally received a benefit; or (2) is entitled to an indemnity from the person who received the money.

[82] While it was not necessary in **Stanford** for the UKSC to decide, as Lord Leggatt notes at para [76], whether the remedy granted in the **West Mercia** case was justified in the light of the decision of the UKSC in **AIB** and whether, if so, the justification is limited to cases such as **West Mercia** where the transaction was an unlawful preference, these issues arise directly in this appeal. In my view, as explained above, the remedy granted in **West Mercia** does not conflict with the decision of the UKSC in **AIB**. I have also accepted earlier that the decision in **West Mercia** applies generally as was recognized by the UKSC in **Sequana** and is not limited to circumstances where the transaction was an unlawful preference. Nothing in the analysis of the judgments in **Sequana** leads to that conclusion.

[83] The liability of a director who breaches the rule in **West Mercia** to compensate for any loss suffered by the company cannot be disputed. In the context of the rule in **West Mercia**, any loss to the general body of creditors following that breach is a loss to the company. The principles of equitable compensation are not undermined by

this analysis. There will be no dilution of the basic compensatory principles which underpin the award of damages for breach of contract and in tort. The compensatory principle does not operate outside the context in which it is invoked. Once the loss is ascertainable, then it applies to allocate the loss to the defaulting party to make good that loss. In other words, ordinary principles governing compensatory damages are applicable, namely, compensation for the loss suffered by the company.

[84] I agree with Lord Leggatt who states at para [81] that the existence of the rule in **West Mercia** does not detract, however, from the fundamental principle of separate corporate personality whereby the rights and obligations, assets and liabilities, and consequently also the losses and gains of a company are in law distinct from those of the persons who have economic interests in the fortunes of the company, be they shareholders or creditors. For reasons already explored above, while the losses and gains are, in my view, clearly different, for the purposes of the existence of the rule of **West Mercia**, the fundamental principle of separate corporate personality is modified. Without that modification, the rule in **West Mercia** would simply not exist. There is no reason to suppose that this modification cannot similarly apply when it comes to determining the existence of loss for the purpose of determining the equitable compensation payable for breach of the rule in **West Mercia**. This analysis does not assume that for all purposes the loss to the creditors is the company's loss. It has a limited purpose in respect of the rule in **West Mercia**.

[85] Lord Leggatt explains at para [81], correctly, in my view, that:

> "Similarly, when a company is insolvent, loss suffered by the company may result in future loss to creditors of the company by affecting the amount that they will be entitled to receive in a subsequent liquidation. But loss suffered by the company and loss suffered by its creditors are different losses and, if the law is to be coherent, it is important not to blur the distinction between them."

[86] However, one cannot accept on the one hand the existence of the rule in **West Mercia** and then, on the other hand, deny that loss to the general body of creditors from a breach of that same rule (whose entire existence is to protect the interests of

same general body of creditors) is not to be equated with a loss to the company. Rather, for the law relating to the rule in **West Mercia** to be coherent, it must be that loss to the creditors resulting from the breach of the rule in **West Mercia** is to be regarded as a loss to the company for the purposes of the principle of equitable compensation. The UKSC in **Sequana** expressly approved of the rule in **West Mercia**.

[87] Respectfully, I do not agree with Lord Leggatt's statement at para [82] that the rule in **West Mercia** has no bearing, however, on whether a payment which a director causes to be made from the company's assets in breach of this fiduciary duty gives rise to a loss to the company. With respect, it must be of critical importance because the rule in **West Mercia** operates in a context that, as noted above, requires the traditional and the fundamental principle of separate corporate personality to be modified, for the limited purpose of the rule in **West Mercia**. The loss arguably is in respect of the very *raison d'etr*e for the rule in **West Mercia**. The simple answer to Lord Leggatt's statement is, to use Lord Sumption's statement in **Bilta** at para [127] that such protection provided by the rule in **West Mercia** would be empty if it could not be enforced.

[88] The approach that has been adopted in this judgment and was the subject of the reasoning of Lord Sales in **Stanford** was rejected by Lord Leggatt who stated at para [83] that it would be contrary to first principles to posit that, at some (imprecise) point on a path that leads to a company going into insolvent liquidation, the nature of its legal personality changes, such that, from then on, any disposition of the company's assets is treated as a loss to the company even if it discharges a liability and so leaves the company's net asset position unchanged. In my view, there is nothing contrary to first principles because the rule in **West Mercia** is an accommodation of the first principles concerning separate legal personality. I agree that there is nothing in the judgments in **Sequana** which supports such a view, and that there is no authority which supports it, but this is unsurprising because the courts have not yet been called upon, until **Sequana**, to confront squarely the foundational issues that

lie at the heart of the rule in **West Mercia**. The question of the appropriate remedy is one of those unanswered issues in **Sequana** for which Lord Reed gave his provisional views at para [105]. No doubt the apex court will be called upon to determine finally one of the most foundational issues concerning the rule in **West Mercia** that did not arise for determination in **Sequana**.

[89] Legal certainty no doubt is an essential principle, particularly in complex corporate and commercial transactions. Lady Arden in **Sequana** explained that:

> "448 The court is of one mind that there needs to be certainty in this area as far as possible. Obviously, judge-made law does not have to and cannot make an obligation clear in every respect from the outset. Working out that obligation is part of the way the common law works. However, the important point is that the existence of the rule under the general law is now clear. The consensus reached at this point in time is important. Company directors need clear guidance. The Supreme Court of Delaware made this point graphically and clearly in Malone v Brincat (1998) 722 A 2d 5, 10, in which it observed, when deciding a question about directors' duties, that it had endeavoured 'to provide the directors with clear signal beacons and brightly lined channel markers as they navigate with due care, good faith, and loyalty on behalf of a Delaware corporation and its shareholders" and also "to mark the safe harbors clearly'. Company law must be ascertainable and applied in real time. Decisions must be taken immediately and cannot await the comparatively leisurely course of litigation. Those are important considerations."

[90] The UKSC in **Sequana** was able to provide clear guidance as to the circumstances in which the rule in **West Mercia** would apply. It was made plain that the point at which the rule is engaged is when the company is insolvent, or bordering on insolvency, but is not faced with an inevitable insolvent liquidation or administration. Once the rule in **West Mercia** is engaged, the foundational principle of separate legal personality shifts, and the interests of creditors become paramount such that any loss that they suffer by reason of a breach by directors of that duty owed to the company becomes a loss suffered by the company. There is no principled basis to reject this approach. I respectfully disagree with Lord Leggatt's statement at para [83] that, as well as being contrary to legal principle, such an approach, if adopted, would introduce considerable uncertainty into an area of law where clear rules are essential. If any uncertainty exists, it resides in the existence of the rule in **West Mercia** itself,

which the UKSC was at pains in **Sequana** to ensure that the necessary clarity and certainty was provided.

[91] Contrary to Lord Leggatt's view, the existence of statutory insolvency regimes that specify a precise period before a company goes into insolvent liquidation within which preferences are liable to be re-opened, is not an argument against the existence of an effective remedy for breach of the rule in **West Mercia**. If anything, it should have been a consideration against the existence of the rule in **West Mercia** in the first place. While the jurisprudential bases for the rule in **West Mercia** in the United Kingdom do not apply here, it is now part of the common law of the Territory of the Virgin Islands. Respectfully, I do not agree with Lord Leggatt's view at para [83] that he does not think that English (or Antiguan) law would be well served by creating a parallel common law regime in which, as from a date about which there would be ample scope for argument, the discharge of a debt is treated as a loss to the company. To the contrary, with respect, the parallel common law regime is not the determination of the nature of the loss relative to the breach of the rule in **West Mercia**; it is the existence of the rule in **West Mercia** itself that has created the parallel common law regime, the existence of which cannot now be questioned in light of its recent recognition and approval by the UKSC in **Sequana**. As Lord Reed made clear in **Sequan**a at para [3] that the proposition that directors are under a duty in respect of creditors' interests raises several questions, including: What are the consequences of a breach of the duty? In particular, what forms of relief are available? These questions follow as a matter of course from the recognition and acceptance of the rule in **West Mercia**.

The dissenting opinion of Lord Sales in Stanford

[92] Lord Sales, dissenting, in **Stanford** after stating at para [107] that a company has representative responsibilities of its own in relation to certain persons who are affected by the management of its affairs and that the concept of "the company", and the corporate personality which corresponds with that concept, serve the function of ensuring that those responsibilities are fulfilled, went on to explain the function served

by corporate personality based on the facts in **Stanford**. In Lord Sale's view, SIB did suffer a loss because of the payment by HSBC of the £116m to the customers. Lord Sales explained his view as follows:

> "108 In my opinion this analysis shows that SIB, the company, did suffer a loss in the circumstances of this case. On the actual facts, at a time when SIB was hopelessly insolvent, SIB's funds held in its accounts with HSBC (to the tune of £116m, as identified by Lady Rose JSC) were used to pay the debts due to the early customers at a time when SIB also had very substantial liabilities owed to other creditors (the late customers). Therefore, at the time when the moneys were paid away, the company's own interests were equated with those of its creditors as a general body. In the counterfactual world, if HSBC had complied with its Quincecare duty, SIB would still have had that fund of £116m in its accounts with HSBC, SIB would have been liable to be placed into insolvent liquidation immediately, and it would in fact have entered liquidation with that fund in its hands. If SIB's own interests at the relevant time had been protected as they should have been, the fund could not have been used to pay the early customers in full but would have had to be retained to pay the early customers and the late customers together a dividend equivalent in each case to only a small fraction of the face value of the debts due to them, but at a higher rate than the late customers will in fact receive."

[93] The critical part of that paragraph is where Lord Sales stated that "at the time when the moneys were paid away, the company's own interests were equated with those of its creditors as a general body". This meant that if SIB's interest were to be protected this could only have been protected if the £116m were not paid to the customers but were retained to pay the general body of creditors in liquidation. The loss to the general body of creditors was the sum of £116m that was paid out to the customers of HSBC. Lord Sales stated that:

> "110 If one treats the company as a pure abstraction whose interests are the same whether it is trading and solvent or whether it is in insolvent liquidation, it may be said that, in a certain sense, it has suffered no loss. By the payments it made to the early customers it reduced the liabilities on its balance sheet and therefore had correspondingly lower liabilities as it entered into liquidation."

[94] This is exactly the point made earlier. Once it is accepted that the interests of the company changes when insolvency is imminent or has set in, any action taken by directors that directly and adversely affect those interests that results in a loss would

amount to a loss to the company. Lord Sales rejected the view that in such circumstances the company would suffer no loss, stating at para [111] that it is not the right way to analyse the position because it leaves out two critical factors:

> "111 … First, SIB paid the early customers more to discharge the debts due to them than they were truly worth at the time, thereby depleting its assets without full value in return and reducing what was available to it to spend in other ways it would have chosen had it appreciated what its true responsibilities were. Second, and related to the first, corporate personality is not a pure abstraction, but has substantive content by reference to the interests which it exists to represent, serve and protect. According to the company's true position when the payments to the early customers were made, it was hopelessly insolvent and such assets as it had (including the fund of £116m held with HSBC) should have been retained for the benefit of the company, which at that time meant for the benefit of the creditors as a general body. Any director who, like Mr Stanford, appreciated that this was the true position owed a duty to the company to retain the fund of £116m so that it could be used to maximise the payments to be made to the general body of creditors (i e treating them all equally): see Sequana. The duty owed reflects the interests of the company itself and the knowledge of the directors is only relevant to trigger their personal fiduciary obligation to take steps in recognition of what are the true interests of the company in such circumstances. Similarly, if SIB had been put into insolvent liquidation as a result of the investigations which should have been made pursuant to the Quincecare duty, the liquidators would have been under an equivalent duty owed to the company to act for the benefit of the creditors as a general body. Again, the duty owed reflects the interests of the company itself."

[95] Lord Sales stated at para [112] that the depletion of SIB's assets by the payment to the early creditors conflicted with the function served by SIB's corporate personality at the time it was insolvent, namely, the protection of the general body of creditors, and that depletion represented a loss to the company. Lord Sales then posed the question at para [113]: where a company is deprived of assets and thereby disabled from fulfilling its proper function in relation to those who have the relevant economic stakes in it and whose interests it exists to promote, is that a loss to the company? He answered it by stating that it is, continuing that impairment of the company's proper function harms the company and constitutes a loss which it suffers. Lord Sales was of the view at para [115] that the Court of Appeal, by treating the company purely as an abstract entity as though for accounting purposes only, failed to have regard

to the true nature of the company's interests which its corporate personality existed to protect. Lord Sales continued that the period in which the payments in breach of the *Quincecare* duty occurred was therefore a period when such payments could not properly have been made because the company's function was to represent its creditors as a general body, its interests being the same as their interests. Lord Sales stated that: (1) as a result of HSBC's breach, therefore, SIB was disabled from performing its proper function to serve and protect the interests of its creditors as a general body, for whom it should have safeguarded the £116 million so that it could be paid out to them; and (2) SIB's loss of that that fund which ought to have been retained by it for that purpose was a loss to the company.

[96] Lord Sales stated at para [118] that the analysis which he would apply also provides a ready explanation for the outcome in **West Mercia** and that the decision of the Court of Appeal in **West Mercia** cannot be brushed aside so easily. Lord Sales explained his views on the issue of "loss" in **West Mercia** as follows:

> "121 In my view, Dillon LJ's reasoning regarding the loss suffered by the subsidiary company, and accordingly suffered by its general creditors through the company itself, is supported in a straightforward way by the analysis set out above. Ms Robertson, on the other hand, sought to explain the outcome in the case on a different basis. She said that on a proper view, consistent with the submission of HSBC in the present appeal, the subsidiary company had not suffered a loss on a "but for" analysis because the payment of the £4,000.00 had discharged a liability it had to its parent, as a creditor. Instead, in West Mercia the liability of the defendant to pay the liquidator a sum equivalent to the £4,000.00 should be grounded in an obligation he owed as a fiduciary to reconstitute the fund from which he had diverted money for his own benefit, even though the beneficiary in relation to his fiduciary duty (the subsidiary) had suffered no loss.
>
> 122 I do not find this explanation persuasive or attractive. It does not accord with the reasoning of Dillon LJ. Having held that the defendant was guilty of a breach of duty by diverting the £4000.00 for his own purposes and in disregard of the interests of the general creditors, Dillon LJ said (p 33) that, prima facie, the remedy was that he should be ordered to repay that money with interest, i e to make good that loss. The relationship between the compensatory principle in relation to breach of duty and possible alternative bases for ordering monetary relief against a fiduciary such as a director is one which raises issues of considerable juristic complexity and controversy: see, eg, Target Holdings Ltd v Redferns [1996] AC 421 and AIB Group (UK)

> plc v Mark Redler & Co Solicitors [2015] AC 1503. We are not in a position to resolve these points on the arguments we have heard on this appeal. I would not wish the sensible and justified approach in West Mercia to be left to depend on the resolution of such issues. It is not obvious to me why the defendant in that case should have been ordered to pay any money if in fact (and contrary to my view) he had caused no loss to the company which was the person to whom he owed the relevant duty.
>
> 123 In any event, I find it difficult to see why the outcome in the present case should depend on such a refined juristic debate. The obligation of a fiduciary to make good the trust fund from which he has diverted money is to make good a loss in the fund which has been created by the diversion of money from the proper use to which it should have been put. To the extent that there is a difference between this principle of reparation and the principle of compensation where a loss is caused by a breach of duty, it appears to me to reflect a difference in how widely one looks at the context in which the assessment of loss is to be made. The former principle focuses on the immediate impact on the trust fund, the latter looks at matters more widely to determine whether there has been a loss overall which ought to be made good. However, in the present case, in my opinion, both principles lead to the same conclusion, namely that the relevant trust fund (the £116m in the hands of the company) has been depleted by being used for improper purposes and a loss has been suffered by the company, representing for these purposes its creditors as a general body."

[97] I agree with Lord Sales' conclusion at para [121] that the decision in **West Mercia** is supported by the views he expressed above and my earlier analysis above. In respect of the analogy with trusts, Lord Sales stated that:

> "125 Lord Leggatt JSC cites at para 61 the well-known explanation given by Lindley LJ in In re Lands Allotment Co [1894] 1 Ch 616, 631, to the effect that directors are treated as if they were trustees of money under their control, so that they are liable to make good moneys misapplied in the same way as a trustee. This reflects the way in which company law grew out of trusts law in the nineteenth century. But it remains to consider how the analogy with trusteeship applies in the case of a company.
>
> 126 Directors do not hold a company's assets at all, let alone hold them on trust for the company. The company's assets are held by the company in its own name, but the directors have control of the company and, through it, control of the company's assets. So when money is under their control in this way, who are the notional beneficiaries for the purposes of the trust analogy? They are the body of persons whose interests are represented by the company.

127 As it was put by Street CJ in Kinsela (1986) 4 NSWLR 722, 730, in a passage cited with approval by Dillon LJ in West Mercia 4 BCC 30, 33, and by Lord Briggs JSC and Lord Reed PSC in Sequana (see paras 130 and 147–148, and paras 31–35 and 45–49):

> ‘In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise … But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.’

Where the company is hopelessly insolvent, in the sense set out above, in a practical sense its assets are held for the benefit of the creditors as a general body. They are the beneficiaries for the purposes of the trust analogy. This is the force of the reasoning in Kinsela, endorsed in West Mercia and in Sequana.

128 In my view, this reflects the point that in the eyes of the law the interests of a company which is hopelessly insolvent are fully aligned with those of its creditors as a general body. In those circumstances the purpose of the company, and the function to be served by its having corporate personality as the vehicle by means of which it holds assets so that they can be used for fulfilling that purpose, is to protect the interests of the creditors as a general body, i e according to the pari passu principle applicable in an insolvent liquidation, subject to any security rights particular creditors might have. The interests of the creditors as a general body, and hence the interests of the company, are prejudiced and damage is suffered if in those circumstances money under the control of the directors (because in the hands of the company) is paid out to satisfy in full the debts of some creditors out of that general body, i e in a way which disregards the principle of equality which applies within that body. When that occurs, the trust fund has become “denuded” (to use the language employed in In re HLC Environmental Projects Ltd [2014] BCC 337, para 142), because it has been misapplied for the wrong purposes and the proper beneficiaries have been made worse off as a result.

129 If the directors have caused that to happen by breach of their fiduciary duty, they will have a liability to restore the fund to what it should have been, as stated in that case and in In re Lands Allotment Co. See also In re Washington Diamond Mining Co [1893] 3 Ch 95, cited by Dillon LJ in West Mercia. Similarly, if the directors have caused that to happen by breach of

> their common law duty of care (para 123 above), they will have a liability to pay damages equal to the loss suffered. And if a third party, like HSBC, has caused that to happen by breach of its common law duty of care, as SIB has alleged has occurred in this case, it too will have a liability to pay damages equal to the loss suffered (provided that the loss falls within the scope of the relevant duty, which is not an issue before us on this appeal and will require to be debated on another occasion: para 88 above)."

[98] I agree with Lord Sales' statement at para [128] that for the purpose of the rule in **West Mercia**, the interests of the creditors as a general body, and hence the interests of the company, are prejudiced and damage is suffered if in those circumstances money under the control of the directors (because in the hands of the company) is paid out to satisfy in full the debts of some creditors out of that general body, i.e. in a way which disregards the principle of equality which applies within that body. In other words, any payment made by directors in breach of the rule in **West Mercia** negatively affects the interests of the general body of creditors and the interests of the company. The directors who act contrary to the rule in **West Mercia** will be liable to pay damages to the company equal to the loss suffered.

[99] Lord Leggatt's criticism at para [83] of the nature of loss identified above, was addressed above at para [88]. The following is Lord Sales' response to Lord Leggatt:

> "135 In my respectful opinion Lord Leggatt JSC's points in para 83 are misplaced for a number of reasons. Statutory insolvency regimes may specify a precise period of time before a company goes into insolvent liquidation within which preferences are liable to be re-opened, but that does not assist a person dealing with the company to know where they stand at the time they so deal, precisely because they will not know then whether the company will go into insolvent liquidation at some later date. The statutory provisions to allow liquidators to unwind preferences expose such persons to greater risk than ordinary equitable principles would do, since they may be liable to repay money even though not on notice when they took it that the company was in difficulty: see the discussion of this in Stanford International Bank (PC) and paras 130–131 above.
>
> 136 Further, the duties of directors and other officers of a company are uncertain to the extent that they depend upon knowledge or notice that the company is hopelessly insolvent, but this has not been an impediment to finding that such duties exist. Since a bank dealing with directors and officers of a company will typically have far less knowledge of the company's affairs than they do, the extent to which the bank will face any

> real uncertainty in knowing how to react to their instructions will be correspondingly less."

[100] For the reasons already stated above, I agree with these criticisms of Lord Legatt's approach to the issue.

Conclusions

[101] The learned trial judge made much of the order of the Privy Council expressed in its order dated 28th February 2022 at para [2] that "[a]ll issues concerning what sums, if any, the respondent must pay to the appellants in respect of or arising from her breaches of fiduciary duty to PFF in relation to the Zenato Payments be remitted to the High Court for decision, in the first instance, by a judge of that court". In my view, the discussion of para [2] of the order at paras [48]-[51] of the judgment of the learned trial judge, and any implications it might otherwise have, were not material considerations in respect of the determination by the learned trial judge of any of the issues arising in the Quantum Application. I agree with the learned trial judge that para [2] of the order of the Privy Council and its use of the words "if any" left open for the learned trial judge to determine the amount for which Miss Chin might be liable for breach of the rule in **West Mercia**.

[102] In my view, it was clear based on the order of the Privy Council and para [96] of its judgment, that any determination under sections 244 and 245 of the Insolvency Act 2003 were not relevant to the Quantum Application. The Quantum Application related to the remedies that the liquidators might have against Miss Chen for breach of the rule in **West Mercia**. These statutory provisions were alternative statutory remedies in respect of the Zenato Payments. Their application had no relevance to any remedy that might be granted to the appellants for breach of the rule in **West Mercia**. The statement by the Privy Council must be read in that context.

[103] The Privy Council also stated at para [96] that there was no need for it to address the question whether, as the appellants have contended, Miss Chen derived a reputational benefit in the making of the payments. The issue concerning the alleged

reputational benefit that Miss Chen might have derived from the Zenato Payments was deployed by the appellants in the context of sections 244 and 245 of the Insolvency Act 2003. It was not surprising that para [96] of the judgment of the Privy Council had the heading "The claim under Insolvency Act 2003". In my view, any reputational benefit that Miss Chen might have derived from making the Zenato Payments was inextricably linked to any potential remedies the appellants might otherwise have under sections 244 and 245 of the Insolvency Act 2003 and was not related to the breach of the rule in **West Mercia**. Additionally, there is no requirement in the rule in **West Mercia**, as I have explained above, for the director to have obtained a benefit by making the payment.

[104] While I agree with the conclusion of the learned trial judge that these two issues are not relevant to the issues raised in the Quantum Application, it was not because the Privy Council excluded them but because they both plainly related to the alternative remedies found in sections 244 and 245 of the Insolvency Act 2003. They are not relevant to the subject matter of the Quantum Application, namely, what remedy, *if any* (if I may), for which Miss Chen is liable in breaching the rule in **West Mercia**.

[105] The learned trial judge noted at para [29] that the need to look at the company's net asset position (as opposed to availability or reduction of available cash) for the purposes of ascertaining whether a transaction has caused the company loss, is supported by the highest authority, citing **Stanford**. For reasons already explained, in the context of a breach of the rule in **West Mercia**, the loss to the general body of creditors is to be treated as a loss to the company. Consequently, the company's net asset position does not reflect the loss to the company when the rule in **West Mercia** is engaged.

[106] The learned trial judge had regard to the decision of the UKSC in **Stanford**. In my view, the decision in **Stanford,** while a persuasive authority of the UKSC, did not directly concern the issue which properly arises on this appeal, although one might argue that by analogy the reasoning of the majority should also apply here. For

reasons explained above, **Stanford** is not the controlling authority in respect of any relief to be granted for any loss suffered by the company following a breach by a director of the rule in **West Mercia**.

[107] As mentioned above, the learned trial judge held at para [67] that since the Zenato Payments were balance sheet neutral this meant that PFF did not suffer a net loss. The learned trial judge continued that, consequently, there was nothing for which PFF needs to be compensated by a payment from the respondent. In my view, had the learned trial judge accepted that the loss to the body of creditors is to be regarded as a loss to the company in the context of a breach of the rule in **West Mercia**, he would not have arrived at this conclusion. In doing so, he erred in principle. I do not agree with the view of the learned trial judge just expressed at para [68] that requiring Miss Chen to make a payment would be penal. In my view, any financial benefit to Miss Chen is not a relevant consideration in determining whether the company suffered any loss because of her established breach of the rule in **West Mercia**. The learned trial judge continued that requiring the respondent to make any payment would be penal and that it was no part of the appellants' case that the respondent obtained a financial benefit by making the Zenato Payments. If the focus is always on whether those to whom the payments are made retain those payments (where the statutory remedies are otherwise not available), then it could always be said that the director whose breach caused the loss to the general body of creditors would not have the funds. As mentioned, the learned trial judge's appreciation of the loss to the company was too narrow, focusing only on whether PFF suffered a net accounting loss.

[108] The learned trial judge also considered whether an equitable remedy along the lines crafted in **West Mercia** should be applied and he answered in the negative. The learned trial judge was wrong to do so, as the rule in **West Mercia** was directly engaged in the earlier proceedings in which the Privy Council had found Miss Chen had breached the rule in **West Mercia**. The decision in **West Mercia** was approved in **Sequana**. It was therefore not open to the learned trial judge to reject the remedial

approach adopted by the Court of Appeal in **West Mercia**. In rejecting that equitable remedy, the learned trial judge noted at para [69] that the director in **West Mercia** had indirectly obtained a benefit from the improper preference paid. I have already explained above that the benefit obtained by Mr. Dodd was not part of the rule in **West Mercia** as explained by Lord Reed in **Sequana**. Consequently, the learned trial judge was wrong to distinguish the decision in **West Mercia** on that basis. When the learned trial judge gave his decision in the court below, the UKSC had already decided **Sequana**, although it appears that it was not brought to his attention. The learned trial judge relied extensively on the decision of the UKSC in **Stanfor**d. The decision in **Sequana** was mentioned in **Stanford** by Lord Legatt at paras [79] to [84] and by Lord Sales at paras [95]-[109], [111], [120] and [127].

[109] There was no need for the learned trial judge to determine and find at para [70] that the respondent did not benefit from the Zenato Payments in any tangible or ascertainable sense. The issue of benefit is not a feature of the rule in **West Mercia**. Consequently, the learned trial judge was wrong to treat it as a precondition for the application of the rule in **West Mercia**. Whether or not the respondent received a reputational benefit is not a material consideration in determining whether the rule in **West Mercia** applied. There was no need for the learned trial judge to consider this as he did in paras [71]-[73] of his written judgment.

[110] In my view, the learned trial judge was wrong to dismiss the Quantum Application at para [78] on the basis that: (1) the only eventual basis for making a payment order was that PFF needed to be compensated for a net loss incurred because of the Zenato Payments; and (2) since there was no such net loss to PFF, no compensation fell due. In my view, in making the Zenato Payments, the company suffered a pecuniary loss equivalent to the financial loss suffered by the general body of creditors.

[111] The question that now arises is whether the appellants are entitled to the two principal orders they sought in the Quantum Application, namely, (1) the respondent do pay

the appellants the sum of US$13m; and (2) the respondent do pay the appellants interest on US$13m at a rate of 5% per annum from 29th November 2009. In my view, the appellants are not in principle entitled to the entire sum of US$13m. In **West Mercia**, the Court of Appeal stated at p. 255 that:

> "In my judgment the appropriate course of administration in the present case is to order Mr Dodd to repay the £4,000 with interest and to direct that in the distribution of the assets of the West Mercia company to unsecured creditors the debt due from the West Mercia company to the Dodd company is to be taken as notionally increased by £4,000 to what it would have been if there had not been a fraudulent preference, and then any dividend attributable to the extra £4,000 thus added back to the debt of the Dodd company is to be recouped to Mr Dodd rather than being paid to the Dodd company. That, as I see it, is a rough and ready way of achieving justice on both sides."

[112] This has become known as the **West Mercia** Proviso, and I would apply it in respect of the appropriate order for relief to be granted to the appellants in this appeal.

Disposition

[113] Based on the foregoing, I would allow the appeal against the decision of the learned trial judge, set aside the orders he made at paras [78]-[81] of the written judgment. I would order the respondent to pay the sum of US$13m with interest at a rate of 5% per annum (from 29th November 2009 until payment) to the appellants, and to direct that in the distribution of the assets of PFF to the general body of creditors the debt due to PFF is to be taken as notionally increased by US$13m to what it would have been if the Zenato Payments had not been made by the respondent in breach of the rule in **West Mercia**, and then any dividend attributable to the extra US$13m is to be added back to the debt of PFF is to be recouped to the respondent rather than being paid to PFF.

[114] The appellants shall have their costs in the appeal and in the court below to be paid by the respondent to be assessed if not agreed within 21 days of today's date.

[115] I am grateful for the assistance provided by learned counsel.

I concur.
Mario Michel
Chief Justice [Ag.]

I concur.
Gertel Thom
Justice of Appeal [Ag.]

By the Court

Chief Registrar