EASTERN CARIBBEAN SUPREME COURT
IN THE COURT OF APPEAL

TERRITORY OF THE BRITISH VIRGIN ISLANDS

BVIHCMAP2013/0008

BETWEEN:

STUART MACKELLAR
(as liquidator of Smart Plus International (Holdings) Limited

Appellant

and

[1] KHOO KIN YONG (aka "Alice")
[2] PENGIRAN HAJID MOHD AYUB
[3] THE AUTHORISED LEGAL REPRESENTATIVE Appointed in the Estate of PENGIRAN ANAK HAJAH DAMIT (Deceased)

Respondents

BEFORE:

The Hon. Mr. Davidson Kelvin Baptiste	Justice of Appeal
The Hon. Mde. Ola Mae Edwards	Justice of Appeal [Ag.]
The Hon. Mde. E. Ann Henry, QC	Justice of Appeal [Ag.]

Appearances:

Mr. Mark Forte, with him, Ms. Rosalind Nicholson for the Appellant
No appearance for the Respondents

2013: September 19;
2016: April 4.

Civil appeal – Insolvency proceedings – Sections 254 and 256 of the Insolvency Act, 2003 – Misfeasance – Whether learned trial judge erred in holding that company never suffered a loss – Whether learned trial judge erred in refusing to hold the respondents personally liable for breach of agreement

Smart Plus International (Holdings) Limited ("Smart Plus") and Coffee Bean Tea Leaf ("CBTL") entered into an Investment Agreement with the undertaking that Smart Plus would invest up to 7.5 million in CBTL by way of share and loan capital. At the time at which Smart Plus entered into this agreement it had no assets. Smart Plus failed to fulfil its undertaking. CBTL commenced proceedings against Smart Plus for damages as a

result of non-performance by Smart Plus of the Investment Agreement. Judgment was entered against Smart Plus in the sum of £46,911,793.00 plus costs in the sum of $208,747.13. An application to set aside that judgment was filed by the second respondent and was granted on the terms that Smart Plus pay the sum of £10,000,000.00 into court. No such payment was forthcoming and final judgment was entered in the stated amount. On the strength of that judgment, CBTL filed an application for the appointment of a liquidator and an order was made to that effect appointing Mr. Stuart MacKellar ("Mr. MacKellar") as liquidator.

Mr. MacKellar filed an application for relief against the respondents under sections 254 and 256 of the Insolvency Act, 2003. The learned judge refused to grant relief holding that the damages to be paid by Smart Plus were not a loss within the meaning of section 254. He was also not satisfied that the respondents were guilty of insolvent trading and refused to make an order under section 256. The appellant has appealed alleging that the learned judge erred in his interpretation of both sections 254 and 256 of the Insolvency Act, 2003.

Held: dismissing the appeal, that:

1. Section 254 of the **Insolvency Act, 2003** provides a summary procedure to make persons, including directors, liable to compensate the company for misfeasance, breach of fiduciary duty or other duty to the company. To hold a director accountable under this section it must be shown that he was guilty of misfeasance or breach of his fiduciary duty or other duty in relation to the company or that he has misapplied or retained or become accountable for any money or other assets of the company.

   Section 254(1)(b) of the **Insolvency Act, 2003** applied.

2. Loss to the company is a requisite element of misfeasance and or breach of other duty within the meaning of section 254. In order to establish loss, it is imperative that there must have been a misapplication of assets, whether that loss consists of a depletion of the company's previously held assets or a diversion of profits or property which would otherwise have been available. It is not enough to simply show breach of duty. Loss must be to the funds and assets of the company. Smart Plus never had any assets at any point, before or after they entered into the Investment Agreement with CBTL. A judgment for damages was awarded against Smart Plus. This was in the form of a liability caused as a result of Smart Plus' failure to perform its obligations under the Investment Agreement. Accordingly, the learned trial judge was correct to hold that the respondents cannot be fixed with personal liability as envisioned under section 254.

   The Right Hon. G. A. F. Cavendish Bentinck M.P. v Thomas Fenn (1887) 12 App Cas 652 applied; **Re Canadian Land Reclaiming and Colonizing Company Coventry and Dixon's Case** (1880) 14 Ch D 660 applied; **QEB Metallics Limited (by its Joint Liquidators, David Ingram and Kevin Murphy v Aslam Peerzada**

et al [2009] EWHC 3348 distinguished; **In Liquidator of West Mercia Safetywear Ltd. v Dodd & Anor** (1988) 4 BCC 30 distinguished; **Malcolm Cohen et al v Gerald Selby et al** [2002] BCC 82 applied.

3. To proceed under section 254 the position would have to be the same as it would be if the company had brought an action in its own name. In this case, there was no credit that was incurred by the respondents in the name of the company. As Smart Plus never had in its balance sheet the sum awarded in the judgment and which sum had been depleted and or misapplied by the respondents and or the respondents were guilty of misfeasance or breach of other duty, it could not have brought an action in its own name against the respondents. Further, there was no evidence that the respondents performed their duties to the company in a manner that was not honest, not in good faith and not in what they believed to be in the best interests of Smart Plus. They also did not retain or became accountable for any money or other assets of the company.

   Section 254(1) of the **Insolvency Act, 2003** applied; **Malcolm Cohen et al v Gerald Selby et al** [2002] BCC 82 applied; **The Right Hon. G. A. F. Cavendish Bentinck M.P. v Thomas Fenn** (1887) 12 App Cas 652 applied.

4. Section 256 is designed to cause directors who incur credit during a period when they ought to have realised there was no chance that the company would avoid going into insolvent liquidation make a contribution to the assets. An insolvent company is one where either the value of the company's liabilities exceeds its assets or the company is unable to pay its debts as they fall due. Smart Plus had no assets and no liabilities. It went into liquidation as it was unable to pay the judgment awarded against it. Smart Plus could not have been an insolvent company before that period. Further, there is no evidence which showed that liquidation proceedings were contemplated or could occur as a result of some action or inaction on the part of the respondents. The respondents could not have reasonably taken steps to minimise loss to Smart Plus' creditors as they never existed until judgment was awarded against Smart Plus for breach of the Investment Agreement. Accordingly, the learned judge was correct in refusing to award relief under section 256 of the **Insolvency Act, 2003**.

   Malcolm Cohen et al v Gerald Selby et al [2002] BCC 82 applied; **Re Hawkes Hill Publishing Co Ltd (in liq)** [2007] BCC 937 applied; **Re Produce Marketing Consortium Ltd** (1989) 5 BCC 569 distinguished.

JUDGMENT

[1] **BAPTISTE JA**: This is a judgment of the Court. This appeal arises from a decision of Bannister J [Ag.] in which he dismissed an application by the appellant for relief under sections 254 and 256 of the **Insolvency Act, 2003**.[1]

Background

[2] A brief background would provide some valuable insight into this appeal so as to place it within context. In December 2001, Heads of Terms and a Term Sheet were signed by the first respondent reflecting that Smart Plus International (Holdings) Limited ("Smart Plus")[2] was an investor in the company Coffee Bean Tea Leaf ("CBTL"). The Term Sheet recorded the intention that Smart Plus would invest up to £7.5million in CBTL by way of share and loan capital. Approximately four months later, no such monies having been invested in CBTL and communications having broken down between the respondents and Mr. Mark Burby ("Mr. Burby"), the director of CBTL, Mr. Burby, in his personal capacity, initiated legal proceedings in Singapore against the respondents. In February 2003, the parties agreed to adjourn the Singapore proceedings to enter into negotiations. The negotiations gave birth to the Investment Agreement between Smart Plus and CBTL which had as its objective to "maximise returns to shareholders of CBTL". The Term Sheet and the Investment Agreement had the same undertaking. At the time at which Smart Plus entered into this agreement it had no assets. Under the terms of the stay of the Singapore Proceedings £300,000.00 was to be paid by Smart Plus to CBTL by 15th March 2003. In September 2003, no payment having been received, Mr. Burby reinstated the Singapore proceedings.

[3] The respondents succeeded in their defence of the Singapore proceedings on the basis that since the investment in the proposed project was to be through their

[1] No. 5 of 2003, Laws of the Virgin Islands.
[2] A BVI incorporated company.

corporate vehicle, Smart Plus, they could not be held personally liable for breaches of the Investment Agreement.

[4] CBTL then commenced proceedings against Smart Plus in the BVI for damages as a result of non-performance by Smart Plus of the Investment Agreement. Judgment was entered on 22nd December 2004 in the sum of £46,911,793.00 plus costs in the sum of $208,747.13. However, an application to set aside that judgment was filed by the second respondent and was granted on the terms that Smart Plus pay the sum of £10,000,000.00 into court. No such payment was forthcoming and final judgment was entered on 4th October 2005 in the stated amount. On the strength of that judgment, CBTL filed an application for the appointment of a liquidator and an order was made to that effect on 17th October 2005 appointing Mr. Stuart MacKellar ("Mr. MacKellar") as liquidator.

Application before Bannister J [Ag.]

[5] Mr. MacKellar filed an application before Bannister J [Ag.] for relief against the respondents under sections 254 and 256 of the **Insolvency Act, 2003** which sections deal with summary remedy against delinquent officers (officers who have been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company) and insolvent trading respectively. It is noteworthy that the respondents never took an active part in this High Court matter and neither in the appeal. An order was given by the High Court for service out which was effected on the High Commission in Brunei as the evidence was that attempts to effect personal service failed. The hearing before Bannister J [Ag.] was the trial of the action.

Bannister J [Ag.] judgment

[6] Bannister J [Ag.] held that although the company now has in its balance sheet the most enormous liability, before recovery can be made under section 254 of the **Insolvency Act, 2003**, it must be shown that the conduct complained of has

depleted the company's assets. This is so as the order which can be made against the directors is made in order to reconstitute the balance sheet in the shape in which it ought to have been had the misconduct not occurred. He held that the loss to which a director is liable is loss which has caused damage to the company; he has either removed assets or diverted assets; or has negligently failed to protect assets when he should have done so.

[7] Bannister J [Ag.] found that Smart Plus had no assets from the inception. As a result of this, there was never anything to be removed or to be diverted from the company, or anything that was removed or diverted from the company. There was therefore no balance sheet to reconstitute. The learned judge did not consider that the damages to be paid by Smart Plus to CBTL were a loss within the meaning of section 254. He stated that the respondents had caused the company to enter into a contract which was not performed. The result was that a huge judgment was entered against the company. He stated that counsel for the appellant was correct to say that the respondents should not have allowed "the position to happen", however that was not sufficient to make them personally liable on a contract which was entered into by Smart Plus. He applied the case of **Salomon v Salomon**[3] in holding that the respondents were completely protected by the principle of separate legal personality.

[8] As it related to insolvent trading, Bannister J [Ag.] found that section 256 is designed to:

> "…make directors who incur credit during a period when they ought to have realised that there was no chance that the company would avoid going into insolvent liquidation … make a contribution to the assets ... so that the difference between the assets as they were when they ought to have appreciated that, as against the level of assets when the company finally … goes into liquidation … is made up."[4]

[3] [1897] AC 22.
[4] See Transcript of Chamber Proceedings at p. 51, lines 8-17.

For those reasons, the learned judge found that the respondents could not be made to pay money into the company either as a result of the breach of duty or the exception that is embodied in section 256 of the **Insolvency Act, 2003**.

Issues arising on appeal

[9] The main issues on this appeal can be crystalised as follows:

(i) whether section 254 of the **Insolvency Act, 2003** applies only where it can be demonstrated that the company concerned had assets which have been depleted, misapplied or taken away;

(ii) whether the liability incurred could be construed as a loss the company suffered for purposes of a claim for misfeasance or breach of fiduciary or any other duty under section 254; and

(iii) whether the learned trial judge erred in holding that section 256 applies where the company incurs trading losses or obtains credit after the time at which the respondent knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

Issues under section 254 – appellant's submissions

[10] Counsel for the appellant, Mr. Forte, states that the cause of action under 254 arose as there was a breach of the duty by the directors to the company which has resulted in a loss. He submits that the breaches consisted of causing and/or permitting Smart Plus to enter into the Investment Agreement without ensuring that it was and or would be in a position to meet its contractual obligations thereunder and later, and continuing to cause or permit Smart Plus to hold out to CBTL that it could and would meet its obligation to invest. Further, that the directors knew from the point at which they committed the company under the Investment Agreement that it would inevitably breach the contract and so be

exposed to a claim by CBTL for damages for breach. CBTL ultimately filed and succeeded on a claim for substantial damages against Smart Plus. Counsel submits in that way a liquidator can bring and succeed on an application for relief under section 254 of the **Insolvency Act, 2003**.

[11] Mr. Forte recognises that as a matter of law, loss to the company is a requisite element of misfeasance within the meaning of section 254. He submits however that the judge's analysis of loss for the purpose of his interpretation of the scope of section 254 was incorrect and that he misdirected himself in putting a narrow construction on the concept of loss. Counsel complains that the judge's definition of loss fails to allow for an increase in liabilities, as distinct from a diminution in assets, which can contribute to the diminution in the overall value of a company as much as a reduction of asset value. An excess of liabilities over assets is one of the definitions of insolvency within section 8 of the **Insolvency Act, 2003**, and as such the balance sheet is central to the scheme of the legislation. If loss is confined to depletion of previously held assets, the status of the balance sheet, which records liabilities as well as assets, is irrelevant to determination of loss. As such, the learned judge's definition is inconsistent with the importance which the legislation puts on the balance sheet, submits counsel. Counsel invites the Court to accept the definition of loss as provided in **Black's Law Dictionary**[5] which defines loss as "an undesirable outcome of a risk; the disappearance or diminution of value, usually in an unexpected or relatively unpredictable way".

[12] Mr. Forte argues that the increase in the company's liabilities could and did constitute a loss to the company and accordingly all the requisite elements of misfeasance and/or breach of duty were established in the case. He argues further that the company's credit was improperly pledged, the end result of which constitutes misfeasance. He submits the cases of **QEB Metallics Limited (by its**

[5] 9th edn., West, 2009.

Joint Liquidators, David Ingram and Kevin Murphy v Aslam Peerzada et al[6] and **Jeremy French et al v Igor Flavio Cipoletta**[7] in support of his proposition that there was a loss to the company and as a result the respondents were guilty of misfeasance and or breach of duty under section 254; accordingly relief should be granted.

[13] Counsel posits that once a claimant has brought himself within the terms of section 254, that is, has established a breach of duty and a loss, the court has no discretion in whether to afford relief; a court must afford relief, the court's only discretion relates to the form of the relief. He submits the case of **Re Paycheck Services 3 Ltd and others**[8] in support of this view.

[14] Mr. Forte contends that the judge fell into error in his application of the case of **Salomon v Salomon** which the judge concluded protected the respondents from liability. He submits that the doctrine of separate legal personality does not trump the liability of directors to compensate the company or its creditors in a case where the statutory exceptions are engaged as in this case, where sections 254 and 256 are engaged.

The law and analysis

[15] Section 254 of the **Insolvency Act, 2003** provides, so far as is relevant, as follows:

> "254. (1) On the application of the liquidator of a relevant company, the Court may make an order under subsection (3) where it is satisfied that a person specified in subsection (2)
>
> (a) has misapplied or retained, or become accountable for any money or other assets of the company; or
>
> (b) has been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company.

[6] [2009] EWHC 3348.
[7] [2009] EWHC 223.
[8] [2010] UKSC 51.

(2) An order under subsection (3) may be made against a person
(a) who is or has been an officer of the company;
…

(3) Where subsection (1) applies, the Court may make one or more of the following orders against the person:

(a) that he repays, restores or accounts for the money or other assets, or any part of it;

(b) that he pays to the company as compensation for the misfeasance or breach of duty such sum as the Court considers just; and

(c) that he pays interest to the company at such rate as the Court considers just.

(4) The Court shall not make an order under subsection (3) unless it has given the person the opportunity

(a) to give evidence, call witnesses and bring other evidence in relation to the application; and

(b) to be represented, at his own expense, by a legal practitioner who may put to him, or to other witnesses, such questions as the Court may allow for the purpose of explaining or qualifying any answers or evidence given."

A relevant company as defined by section 253(b) is a company that has gone into insolvent liquidation, thus making Smart Plus a relevant company within the meaning of the section.[9]

[16] It is important to examine the purpose and scope of section 254 of the **Insolvency Act, 2003**. It provides a summary procedure to make persons, including directors, liable to compensate the company for misfeasance, breach of fiduciary duty or other duty to the company. To hold a director accountable under this section it must be shown that he was guilty of misfeasance or breach of his fiduciary duty or

[9] This was however not in dispute.

other duty in relation to the company or that he has misapplied or retained or become accountable for any money or other assets of the company.[10] The liquidator in the present appeal is arguing that the breaches in this case were the respondents undertaking contractual obligations at a time when the company had no assets, had secured no source of funding and had no means of meeting its obligations under that agreement. Further, no steps were ever taken by the respondents to secure third party funding for the company to fulfil its contractual obligations. He submits that the damages to be paid by Smart Plus to CBTL are the resulting loss of this breach.

[17] Section 120 of the **BVI Business Companies Act, 2004**,[11] under the rubric duties of directors and conflicts, a basic element of company law, establishes that a director of a company, in exercising his powers or performing his duties, shall act honestly and in good faith and in what the director believes to be in the best interests of the company. What was the wrong or misconduct done? Can it be said that the respondents, by either entering into the Investment Agreement without assets being available to the company or by having not secured the funds to invest in CBTL, breached their fiduciary duty as prescribed by section 120 of the **BVI Business Companies Act, 2004**? Can it be said that the respondents, by either entering into the Investment Agreement without assets being available to the company or by having not secured the funds to invest in CBTL, has been guilty of any misfeasance or breach of other duty in relation to the company? These are the critical questions which were, to my mind, addressed by the court below. The wording of the section states that "…the Court may make an order under subsection (3)[12] where it is satisfied…" Bannister J [Ag.] was not satisfied that the respondents had been guilty of any misfeasance or breach of any fiduciary or

[10] See section 254(1).
[11] No. 16 of 2004, Laws of the British Virgin Islands.
[12] See 254(3) above.

other duty in relation to the company; accordingly he did not make an order under section 254(3).

[18] Learned counsel submits that the power conferred by section 254(3) is not a discretionary one; a court must afford relief where a clamant has brought himself within the terms of section 254 and in dismissing the claim, the learned judge fell into error. He says that the case of **Re Paycheck Services 3 Ltd and others** supports this contention. In that case, Lord Hope of Craighead stated:

> "…there is the question whether the liability for the payment of unlawful dividends is strict or depends on a degree of fault being established. There are two lines of authority on this issue. On the one hand there are cases in which it has been said without qualification that directors are under a duty not to cause an unlawful and ultra vires payment of a dividend… On the other there is a line of authority to the effect that a director is only liable if he makes a misapplication of a company's assets if he knew or ought reasonably to have known that it was a misapplication…
>
> "The trend of modern authority supports the view that a director who causes a misapplication of a company's assets is in principle strictly liable to make good the misapplication, subject to his right to make good, if he can, a claim to relief under section 727 [of the Companies Act] 1985 . The authorities that favour the contrary view really come to an end with Dovey v Cory [1901] AC 477 , as the later judgment of Romer J in Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 can be read, at least in relation to dividends, as supporting strict liability. Furthermore, the whole point of introducing the right to claim relief under section 727 was to enable the court to mitigate the potentially harsh effect of being held strictly liable…
>
> "…the … view seems to me that in cases such as this, where it is accepted that the payment of dividends was unlawful, a director who causes their payment is strictly liable, subject of course to his right to claim relief under the statute."[13]

[19] Lord Hope went on to state at paragraphs 49 and 51:

> "49. Where dividends have been paid unlawfully, the directors' obligation is to account to the company for the full amount of those dividends…

[13] See paras. 45, 46 and 47.

> "51. I agree … that the discretion under section 212(3), [which is analogous to section 254(3) of the **Insolvency Act, 2003**] which is essentially procedural in nature, is a discretion as to amount only once liability has been established. It is not so wide as to allow the judge, having determined that the section applies, to decline to make any order at all... The discretion which he is given by section 212(3) is as to the order that would be appropriate once liability has been established, not to grant relief against liability. It is a discretion as to how much the director should be ordered to pay, so as to do what is just in all the circumstances…"

[20] In **Re Paycheck Services 3 Ltd and others** the deputy judge had found that certain dividend payments were unlawful; there had been no challenge on appeal on that point. The directors in this case caused Smart Plus to sign an Investment Agreement; the company breached that agreement and a judgment for damages was awarded against Smart Plus. There had been no unlawful payment of dividends, no misapplication of any assets which would have been impossible as Smart Plus never had any assets; there was also no loss to the company.

[21] Lord Hope was clearly speaking to dividends that have been paid unlawfully. That money was therefore no longer available for the company to pay its creditors; there had been a shortfall. In relation to whether on a finding of liability the court must make an order, I agree with his Lordship that the intendment of the legislature was that once a court was satisfied of liability under section 254(1) then the discretion exists as to the amount of relief to be awarded. That is clear from a reading of section 254(3). Any other interpretation would deprive that section of efficacy.

[22] There was no evidence that the respondents performed their duties to the company in a manner that was not honest, not in good faith and not in what they believed to be in the best interests of Smart Plus. Moreover, they did not misapply, retain or become accountable for any money or other assets of the

company. It must be remembered that fraud was not alleged against any of the respondents. The evidence below showed communications between the first respondent and Mr. Burby with the first respondent indicating at all times that the intention was to fulfil Smart Plus' obligations. In fact, the first respondent's affidavit in the Singapore proceedings indicated that Smart Plus had fully intended to comply with the terms of the Investment Agreement and that up to the date when Mr. Burby had reinstated the proceedings in Singapore, efforts were being made to effect the transfer of funds to CBTL.

[23] All the same, section 254 covers where any officer has been guilty of misfeasance or breach of other duty which is the breach of a common law duty - negligence. Evershed MR in defining misfeasance as it appeared in section 333 of the Companies Act 1948 of the UK in the case of **In Re B. Johnson & Co. Builders Ltd**.[14] at page 648 stated that:

> "There is no such distinct wrongful act known to the law as "misfeasance." The acts which are covered by the section are acts which are wrongful, according to the established rules of law or equity, done by the person charged in his capacity as "promoter, director," etc."

[24] Loss is a necessary element of misfeasance. In **The Right Hon. G. A. F. Cavendish Bentinck M.P. v Thomas Fenn**,[15] Lord Herschell succinctly set out this principle:

> "And, therefore, I think, that assuming that a breach of duty such as is suggested would be a misfeasance giving rise to an application … such an application could only succeed where it could be shewn that the breach of duty had resulted in loss to the funds and assets of the company."[16]

Lord Macnagthen also had this to say:

> "…and it has been settled, and I think rightly settled, that that section creates no new offence, and that it gives no new rights, but only provides a summary and efficient remedy in respect of rights which apart from that section might have been vindicated either at law or in equity. It has also

[14] [1955] Ch 634.
[15] (1887) 12 App Cas 652.
[16] At p. 662.

been settled that the misfeasance spoken of in that section is not misfeasance in the abstract, but misfeasance in the nature of a breach of trust resulting in a loss to the company."[17]

A liquidator would also need to prove loss to the company in breach of duty within the meaning of section 254(1)(b).[18]

[25] Section 254 is analogous to section 212 of the **UK Insolvency Act 1986**. In that regard, there are various English authorities from which guidance can be gleaned. Borrowing from the language of Lord Justice Chadwick in **Malcolm Cohen et al v Gerald Selby et al**:[19]

> "Section 212 is the successor to section 333 of the Companies Act 1948… It provides a summary procedure in a liquidation for obtaining a remedy against delinquent directors without the need for an action in the name of the company. **It does not, of itself, create new rights and obligations** — see In re City Equitable Fire Insurance Company, Limited [1925] Ch 407, 507. The scope of the section was enlarged by the 1986 Act … to include "breach of other duty"; thereby removing the limitation imposed by the concept of misfeasance which had been identified by Sir Raymond Evershed MR in In re B Johnson & Co (Builders) [1955] Ch 634, at page 648. There can be no doubt, now, that a liquidator can proceed under section 212 of the Insolvency Act 1986 where all that is alleged is common law negligence. **But, if he does so, he must establish a cause of action at common law; that is to say, he must show that the breach of duty of which he complains has caused loss or damage**. In my view, when exercising the power, conferred by section 212(3)(b), to compel a delinquent director "to contribute such sum to the company's assets by way of compensation in respect of the … breach of … other duty" in a case where the breach of duty complained of is a breach of the common law duty to take care, **the court has to be satisfied that the negligence has caused a loss in respect of which compensation can be awarded**. **The position, in this respect, is the same as it would be if the company had brought an action in its own name**."[20] (My emphasis).

[17] At p. 669.
[18] Malcolm Cohen et al v Gerald Selby et al [2002] BCC 82.
[19] [2002] BCC 82.
[20] At para. 20.

Applying that principle to the present appeal, the appellant would need to show that there was a breach of the duty owed to the company by the respondents and that this breach has caused loss or damage for which compensation can be awarded. The position is the same as it would be if Smart Plus had brought an action in its own name.

[26] The appellant argues that the respondents knew from the point at which they committed the company under the Investment Agreement that it would inevitably breach the contract and so be exposed to a claim by CBTL for damages for breach. I find that there is no force in that argument. In essence, counsel is asking this Court to accept that the respondents intentionally entered into an agreement that they knew they could not perform; further, they knew, because it could not be performed, that substantial damages would be entered against Smart Plus; that is they knew from the very beginning that Smart Plus would have to pay damages to CBTL. That view begs the question, why would the respondents with their level of knowledge and skill and business acumen (which knowledge and skill is expected and presumed as a director of a company) open themselves up to an application such as this one? I reject that view. It is prudent to state that fraud was not alleged against the respondents; what was alleged was misfeasance (which requires there to be a loss to the company) and breach of a common law duty – negligence (which also requires there to be a loss to the company).

[27] Can damages entered against a company be in the nature of a loss suffered by the company? I agree with the learned trial judge that this amounts to a liability and not a loss.

[28] To develop this further, it is necessary to examine the authorities to determine if the damages to be paid to CBTL can be categorised as a loss suffered by the company and is capable of constituting misfeasance and or breach of duty. In **Re Canadian Land Reclaiming and Colonizing Company Coventry and Dixon's**

Case[21] two gentlemen were appointed, and for some time acted, as directors of a company in which the qualification for a director was the holding of 100 shares. Neither of them was the holder of any shares. No act of misfeasance was alleged against either of them for which he would have been liable if he had been a duly qualified director. Winding up proceedings were later commenced. The liquidator applied under section 165 of the Companies Act, 1862, (the precursor to section 212) to charge them for misfeasance in acting as directors without qualification. Jesse MR held that by acting as directors they had been guilty of a misfeasance, for which they were liable under the Companies Act, 1862, section 165, and ought to be ordered to pay a sum equal to the nominal amount of the shares requisite to qualify them to be directors. On appeal, James LJ dismissed the application after failing to see what the gentlemen as directors had done or omitted to do which caused the company any damage and said:

> "In order to enable the Court to apply that section, the liquidator, as it seems to me, must shew something which would have been the ground of an action by the company if it had not been wound up… "**misfeasance**" …. means misfeasance in the nature of a breach of trust, that is to say, it **refers to something which the officer of such company has done wrongly by misapplying or retaining in his own hands any moneys of the company, or by which the company's property has been wasted, or the company's credit improperly pledged**. **It must be some act resulting in some actual loss to the company**."[22] (My emphasis)

[29] In **QEB Metallics Limited**, a company involved in a variation of a missing trader intra-community fraud scheme had been placed into compulsory liquidation, pursuant to a petition by Revenue and Customs for failure to account for VAT on certain transactions. An individual who was never formally a director, but was the controlling mind behind the company was found liable by the learned judge to compensate the company for the full loss of the VAT. Seventy transactions were identified whereby the company had sold precious metals to a German company which gave rise to a VAT liability. The company therefore should have made four

[21] (1880) 14 Ch D 660.
[22] At p. 670.

VAT returns over the relevant period of assessment; however, only three were filed showing a nil return, and no VAT return was filed for the last quarter. Consequently, no VAT had been accounted for and paid. The liquidator had submitted that the defendants were liable to compensate the company for the amount of the VAT foregone, which submission found favour with the learned judge as he held that the relevant directors were guilty of misfeasance and breaches of the duty of good faith and conspiracy to injure the company in carrying out their fraudulent design to deprive Her Majesty's Revenue and Customs of the VAT due and he made an order under section 212 of the UK Insolvency Act 1986 in the amount of the VAT withheld.

[30] It can be seen from that case that the company at one point had the money to pay the VAT. However, the relevant directors failed to fulfil this obligation at the material time it ought to have been fulfilled. As the company went into liquidation it was now left with a debt which had to be satisfied. It is sensible that the relevant directors should have been made to compensate the company since it was their fraudulent scheme that caused loss to the company.

[31] It is important to note that liability under section 254 is imposed on those who are in a position to prevent damage to creditors by taking proper steps to protect their interests. Smart Plus had no creditors; it had an obligation to fulfil under the Investment Agreement which it never did. There were never any creditors' interests for the respondents to protect. That is the distinguishing factor in the **QEB Metallics Limited** case. In that case, the creditor was Her Majesty's Revenue and Customs; in this case Smart Plus had no creditor; a judgment was entered against Smart Plus, which is in the nature of a liability.

[32] The case of **Jeremy French et al v Igor Flavio Cipoletta** is also very instructive. It concerned an appeal against an order dismissing an application for an order striking out certain paragraphs of a claim. The applicants as liquidators of E D

Games Limited (the company) had sought an order under section 212 of the Insolvency Act 1986 that Mr. Cipolletta contributes such sum to the company's assets by way of compensation for misfeasance or breach of fiduciary duty or other duty as the court might think just. The liquidator's primary case, was that Mr. Cipolletta deliberately caused the company not to fill in and send back VAT returns for a period of about 22 months and also failed to account to the Inland Revenue for PAYE and NIC. Alternatively if, as Mr. Cipolletta has claimed, he left these matters to his bookkeeper and was unaware of what was happening, he was in breach of his duty of care in connection with the management of the company's financial affairs. The learned judge, Mr. Jonathan Gaunt, QC, confirmed that proof of loss to the company is a necessary ingredient of a cause of action for breach of a fiduciary duty or negligence under section 212 of the UK Insolvency Act 1986. He accepted that a failure to pay tax does not of itself result in the loss of a sum equivalent to the unpaid tax, any more than the acceptance of a loan can be described as a loss. He highlighted that the liquidator may have considerable difficulties in establishing the necessary causal link between failure to pay the VAT monies and losses equivalent to or greater than those sums causing damage. He went on to state:

> "It is clear that the breaches of duty referred to … are the deliberate non-payment of VAT, alternatively the negligent management of the Company which permitted that non-payment to occur. It is clear … that what is being said is that the Company used the VAT money to buy stock and go on trading when it would not otherwise have been able to afford to do so.
>
> "…it is sufficiently clear … that what is being alleged is that losses were suffered by the Company during the period when it traded using the money to buy stock which it should have paid to the Crown Departments. That is enough for present purposes. While I can see that the Liquidator may face difficulties both in proving causation and in identifying and quantifying the precise losses which flow from the breach alleged, I cannot be certain at this stage that the claim will fail nor can I form the view that there are no reasonable prospects of it succeeding."[23]

[23] At paras. 28 and 30.

[33] Counsel submits that in that case the learned judge had accepted that penalties and fines incurred by a company as a result of a failure to account for VAT were capable of constituting loss to the company. That is an incorrect submission as it does not reflect accurately what was said by the learned judge. The learned judge had in fact accepted that the liquidator may have considerable difficulties in establishing the necessary causal link between failure to pay the VAT monies and losses equivalent to or greater than those sums and in identifying and quantifying the precise losses which flowed from the breach alleged. The basis on which the learned judge allowed the matter to proceed was because he plainly recognised that what was being alleged was that the losses were suffered by the company during the period when it traded using the money it had to pay VAT to buy stock and as a result of this the company had no money to pay its VAT liability. It must be remembered that this case was an appeal against a decision which dismissed an application to strike out certain paragraphs of a claim. That was what the trial judge was dealing with. The company in that case clearly had assets at some point which was later alleged to have been misapplied by the director. The facts of this case are clearly distinguishable from the facts of the present case. Payment of a VAT liability and damages entered against a company are two different liabilities. The case of **Jeremy French et al v Igor Flavio Cipoletta** simply does not go that far to equate them both.

[34] **Re Loquitur Limited et al v Richmond et al**[24] was referred to in **Jeremy French et al v Igor Flavio Cipoletta**. In that case, the Commissioners of Inland Revenue had applied under section 212 against former directors for declaring and paying an unlawful dividend. The directors were ordered to make compensation to the company limited to the corporation tax liability arising on a particular transaction. The learned judge in **Jeremy French et al v Igor Flavio Cipoletta** was careful to

[24] [2002] CWLC 430 (CH).

point out that that was a case where the breach of duty caused a loss greater than the tax liability and is not authority that the unpaid tax is recoverable in the absence of such a loss flowing from the breach of duty. This observation, to my mind, is highly relevant.

[35] Another successful application of section 212 (which section is analogous to section 254 of the **Insolvency Act, 2003**) is illustrated in the case of **In Liquidator of West Mercia Safetywear Ltd. v Dodd & Anor**.[25] West Mercia Safetywear Ltd. ("the West Mercia Company") went into liquidation; Mr. Dodd, at all material times, was the director of that company. There was another company involved, of which Mr. Dodd was also a director, called A.J. Dodd & Co. Ltd. ("the Dodd Company") The West Mercia Company was a wholly owned subsidiary of the Dodd Company. Both companies were in financial difficulties and later became insolvent. West Mercia Company had owed the Dodd Company £30,000.00. An accountant was called in to advise the directors, including Mr. Dodd, on any necessary steps towards the liquidation of the companies. The evidence clearly established that the accountant explained to Mr. Dodd that the bank accounts of the Mercia Company were not thereafter to be operated. Despite this knowledge, Mr. Dodd instructed the bank to transfer £4,000.00, which had just been paid in by a debtor to the West Mercia Company's account, to the overdrawn account of the Dodd Company. The plain and obvious intention of that was to reduce the overdraft of the Dodd Company which Mr. Dodd had personally guaranteed. Meanwhile, both companies were both put into creditors' voluntary liquidation. In due course, the liquidator applied to the court 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. The Court of Appeal found that there had been blatant fraudulent preference and misfeasance on the part of Mr. Dodd when he caused the transfer to be made in disregard of

[25] (1988) 4 BCC 30.

the general creditors of the insolvent company. It ordered that the money be repaid with interest.

[36] This case can again be distinguished on the facts from the present appeal. At no point was there any official (accountant) advice to the respondents about the accounts of Smart Plus and that they should not be trading or be in operation. Furthermore, the company in **In Liquidator of West Mercia Safetywear Ltd. v Dodd & Anor** had creditors with whose interests the directors should have taken into consideration; Smart Plus had none until a judgment for damages was entered against it. **Liquidator of West Mercia Safetywear Ltd. v Dodd & Anor.** followed the case of **Kevin Hellard et al v Horacio Luis De Brito Carvalho**[26] where, on an application by a liquidator under section 212 of the UK Insolvency Act 1986, a director was made to repay to the company monies he wrongfully paid out of the company despite having knowledge that the company had been unable to pay its debt and its creditors.

[37] Following from these cases, it is pellucid that there must be some depletion or misapplication of assets causing a loss to the company to sustain an application under section 254 of **Insolvency Act, 2003**. Smart Plus never had any assets at any point. Loss must be to the funds and assets of the company;[27] as Smart Plus never had any assets, in that regard, the learned trial judge was correct to hold that Smart Plus never lost anything and for section 254 to be invoked there must have been some deficiency in the assets. As was held in **Malcolm Cohen et al v Gerald Selby et al**, the court has to be satisfied that the negligence has caused a loss in respect of which compensation can be awarded. I am not so satisfied.

[38] What exists is a liability that Smart Plus is faced with. The liability was caused as a result of Smart Plus having failed to perform under an Investment Agreement it

[26] [2013] EWHC 2876.
[27] The Right Hon. G. A. F. Cavendish Bentinck M.P. v Thomas Fenn, (1887) 12 App Cas 652.

had committed to. How then can this Court award compensation against the respondents for a liability incurred by a company which had suffered no loss and had no assets to be misapplied, depleted or otherwise? Further, as Lord Justice Chadwick said in **Malcolm Cohen et al v Gerald Selby et al**, to proceed under section 254 the position would have to be the same as it would be if the company had brought an action in its own name. Would Smart Plus have been able to bring a viable claim against the respondents for misfeasance and or breach of duty on the basis of a loss suffered? The answer, in my view, would be no, as Smart Plus never had in its balance sheet the sum awarded in the judgment which had been depleted and or misapplied by the respondents. Further, the learned judge's observations in **Jeremy French et al v Igor Flavio Cipoletta** about the case of **Re Loquitur Limited et al v Richmond et al** where he indicated that that case is not authority that the unpaid tax is recoverable in the absence of such a loss flowing from the breach of duty is quite profound to my mind. There must be a loss flowing from the alleged breach of duty.

[39] Even if it can be said that the respondents, by their failure to act in generating funds for Smart Plus, or, by their continued averment that funds would be ascertained despite acknowledging that a claim for damages can be sustained if funds were not forthcoming, satisfied the common law breach of duty, it is not enough to only show a breach of that duty. There must also be loss as a result of that breach. Counsel's argument that the judgment against Smart Plus is a loss is an impossible construction of the definition of loss in relation to misfeasance; it is unworkable on every basis. The Oxford dictionary defines loss as the amount of money lost by a business or organisation; implicit in that definition is the notion that there was at some point money available before it could have been lost. Further, even the definition urged on the Court by counsel for the appellant in Black's Law defines loss as the disappearance or diminution of value. There was no disappearance or diminution of value of any assets in this case.

[40] I am fortified in this position having also considered the case of **Galoo Ltd. (in liquidation) and others v Bright Grahame Murray (A firm) and Another**[28] where LJ Glidewell held that the mere acceptance of a loan could not amount to a loss causing damage. So too a liability that has been imposed on a company could not amount to a loss caused by the respondents from their alleged breach of duty and or misfeasance.

[41] In my judgment, in order to establish loss it is imperative that there must have been a misapplication of assets, whether that loss consists of a depletion of the company's previously held assets or a diversion of profits or property which would otherwise have been available. All the above cases show that there had been a misapplication and or depletion of the company's assets. In this case, there was no credit that was incurred by the respondents in the name of the company. Simplistically, Smart Plus entered into an agreement and failed to meet its obligations. Flowing from this, a judgment was entered against them. That is in the form of a liability and can in no way amount to a loss caused or created by the respondent's breach of duty. I agree with counsel's submission that the doctrine of separate legal personality does not trump the liability of directors to compensate the company or its creditors in a case where the statutory exceptions are engaged (for example section 254). However in this case section 254 was not engaged.

[42] For the above reasons, and in the circumstances of this case, I disagree with learned counsel that the learned trial erred. Accordingly, this ground of appeal is dismissed.

Whether the learned trial judge erred in holding that section 256 applies where the company incurs trading losses or obtains credit after the time at which the respondents knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation

[28] [1994] 1 WLR 1360.

[43] Mr. Forte contends that the judge's definition of section 256 of the **Insolvency Act, 2003** is incorrect. He submits that what is required is that at a time before the commencement of the liquidation of the company, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. He says that there are only two issues for a court in considering a claim under section 256: (i) whether or not, and at what date, prior to the commencement of the liquidation there ceased to be a reasonable prospect of avoiding insolvent liquidation and (ii) whether the directors knew or ought to have known that fact.

[44] Mr. Forte posits that once the liquidator has shown that there was no reasonable prospect of avoiding an insolvent liquidation, the burden of proof shifts to the director to show that he took all steps reasonably open to him to minimise the loss to the company's creditors. He says that Smart Plus existed for one purpose, which was to enter into and carry out its contractual obligation to invest. It then could not and was not able to meet its obligations under the contract. The company was therefore insolvent from the point at which it entered into a contractual obligation to make an investment which it was unable to make. However, rather than coming clean at an early stage, allowing CBTL to mitigate its loss by sourcing funding elsewhere, the respondents continued to hold out the promise that the payments would be made. Counsel submits that it must have become or ought to have become increasingly clear that Smart Plus was liable to be at the receiving end of a claim by CBTL for breach of contract. He submits that the **Insolvency Act, 2003** does not require an applicant to pin point a date at which the prospect of avoiding insolvent liquidation disappears. He says that in Smart Plus' case this must have been no later than the point at which they entered into the Investment Agreement as a means of compromising the Singapore Proceedings.

[45] Mr. Forte submits that the relief available under section 256 is not confined to making up any shortfall or reversing any trading losses incurred during a period of trade. He highlights that the word trade is not used at all in the section other than in the title. It does refer to incurring liabilities or as the learned judge puts it, credit. Accordingly the section is apt to include incurring liabilities without incurring further debts. Counsel submits the case of **Re Produce Marketing Consortium Ltd**[29] in support of his arguments.

The law and analysis

[46] The law governing insolvent trading exists in section 256 of the **Insolvency Act, 2003**. It is appropriate to set out that section in sufficient detail:

> "(1) On the application of the liquidator of a relevant company, the Court may make an order under subsection (2) against a person who is or has been a director of the company if it is satisfied that
>
> > (a) at any time before the commencement of the liquidation of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and
> >
> > (b) he was a director of the company at that time.
>
> (2) Subject to subsection (3), where subsection (1) applies, the Court may order that that the person concerned makes such contribution, if any, to the company's assets as the Court considers proper.
>
> (3) The Court shall not make an order against a person under subsection (2) if it is satisfied that after he first knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation, he took every step reasonably open to him to minimise the loss to the company's creditors.
>
> (4) For the purposes of subsections (1) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps reasonably open to him which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both

[29] (1989) 5 BCC 569.

> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and
>
> (b) the general knowledge, skill and experience that that director has.
>
> (5) The reference in subsection (4) to the functions carried out in relation to a company by a director of the company includes any function which he does not carry out but which have been entrusted to him.…"

[47] Implicit in this section is an objective and subjective test which a court will apply to determine whether to make an order against a director. A finding of contribution to the company's assets is at the court's discretion. Section 214 of the UK **Insolvency Act** 1986 is comparable to section 256 of the **Insolvency Act, 2003**; it is, in some respects, the mirror image of section 256. In **Malcolm Cohen et al v Gerald Selby et al** Lord Justice Chadwick stated at paragraph 21:

> "… s. 214 applies only where, at some time before the insolvent liquidation, a person knew or ought to have concluded that there was no reasonable prospect that that fate could be avoided… subs. (4) provides a useful exposition of the standard of care required of a director in relation to the facts which he ought to have known, the conclusions which he ought to have reached and the steps which he ought to have taken. I am content to assume (without so deciding) that, on an application under s. 214 of the Insolvency Act 1986, it may not be necessary to establish a causal link between the wrongful trading and any particular loss."

[48] Mr. Forte has to satisfy the Court that the respondents at any time before the commencement of the liquidation of the company, knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

[49] When deciding whether a director of an insolvent company knew or ought to have known that there was no reasonable prospect of the company avoiding liquidation, the court will judge the director by the standards of a person fulfilling that function

with reasonable diligence, and would also have regard to the functions of that director and the nature of the company's business. On that basis, the director would be treated as possessing information which he ought to have ascertained, and which was capable of being ascertained by him had the company complied with its statutory duties.[30] The agreement before this Court was signed in February 2003. Payments to satisfy obligations under the Investment Agreement were supposed to have begun in March 2003, however no such payments having been forthcoming, proceedings in Singapore were reinstated in that same year and proceedings in the BVI against Smart Plus commenced in 2004. Judgment was entered on 22nd December 2004 in favour of CBTL.

[50] Counsel submits that as it could not meet its contractual obligations, Smart Plus was an insolvent company and that throughout this period it must have become increasingly clear that Smart Plus was liable to be at the receiving end of a claim by CBTL for breach of contract.

[51] I do not agree that Smart Plus at this period was an insolvent company. The **Insolvency Act, 2003** dictates that an insolvent company is one where either the value of the company's liabilities exceeds its assets or the company is unable to pay its debts as they fall due.[31] Applying the plain and ordinary meaning of section 8(1)(c) to Smart Plus' framework, Smart Plus could not have been an insolvent company before judgment was entered against it. Smart Plus had no assets and no liabilities; it was on equal footing on either side of its balance sheet. Contrary to what counsel submits, the obligation Smart Plus had was to invest in CBTL under the Investment Agreement as opposed to meet a debt imposed under the Investment Agreement. The monies that were contemplated that would be invested in CBTL were not in the form of a debt. Consequently the liabilities of Smart Plus, at that time, did not exceed its assets. They were both nil.

[30] Re Produce Marketing Consortium Ltd (1989) 5 BCC 569.
[31] Section 8(1)(c) of the Insolvency Act, 2003.

[52] Section 256(1)(a) and 256(3) must be read together. In my view, it is significant that this particular section refers to "company's creditors". The relevant question would then be, who were Smart Plus' creditors at any time before the commencement of the liquidation? Smart Plus went into liquidation as it was unable to pay the judgment awarded against it. Before that period, there is no evidence which showed that liquidation proceedings were contemplated. There were no steps to be taken to minimise loss to Smart Plus' creditors; simply, it had no creditors.

[53] Mr. Forte takes issue with the judge's interpretation of section 256. The judge said that section 256 is designed to make directors who incur credit during a period when they ought to have realised there was no chance that the company would avoid going into insolvent liquidation make a contribution to the assets. The complaint, however, is misplaced as that is precisely the scope and intent of the section.

[54] In **Re Produce Marketing Consortium Ltd** the company acted as agents in connection with the importation of fruit. It was incorporated in 1964. At first, trading was successful but gradually the number of directors, the turnover and the profitability shrank. By 1981, the respondents were and remained the sole directors until the company went into creditors' voluntary liquidation in 1987. From 1981 the company had traded at a steadily increasing loss, its liabilities (principally to its bankers and one major supplier of fruit) growing correspondingly greater. Even though the company had a history of filing its accounts late, it was clear by February 1987, because the auditors so advised, that PMC was insolvent. The liquidator sought an order under section 214 of the Insolvency Act 1986.

[55] It was held in that case that the directors should contribute towards the company's assets. The directors ought to have concluded at the end of July 1986 that there was no reasonable prospect that the company would avoid going into insolvent liquidation. Although they did not have the accounts in their hands until January

1987, they had an intimate knowledge of the business and must have known that turnover was well down on the previous year: that meant a loss, which in turn meant an increase in the deficit of assets over liabilities. As section 214(4) included a reference not only to facts which a director ought to know but also to those which he ought to ascertain, the court assumed, in applying the test in section 214(2)(b) that the financial results for the year ending 30th September 1985 were known at the end of July 1986. Further, the court found that the respondents did not take every step which they ought to have taken under section 214(3) since they went on trading for a year after July 1986.

[56] In that case, unlike in the present case, the company had traded at a steadily increasing loss for over 6 years. Smart Plus never traded at any point; there was no period of loss experienced. The evidence before the lower court was that Smart Plus intended to fulfil its contractual obligations. There were no assets and no liabilities so as to indicate that its liabilities exceeded its assets and it could potentially result in a situation of insolvent liquidation. The director's conduct is assessed by reference to a reasonably diligent person having both the general knowledge, skill and experience reasonably expected of a person carrying out the director's functions, and the general knowledge, skill and experience that the particular director actually has. In that regard, a reasonably diligent person having the general knowledge, skill and experience of the respondents would not have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. There was no evidence presented at the lower court which would have led the judge to the inevitable conclusion that Smart Plus knew or ought to have known this.

[57] There were proceedings in Singapore filed by Mr. Burby against the respondents as a result of a failure to produce the investment monies promised under the Term Sheet. It was the evidence at the lower court that the respondents at that time were negotiating on behalf of Smart Plus. Those proceedings were adjourned to

facilitate a new agreement. It leads one to question why then would Mr. Burby, after having failed to receive investment funds from the respondent, knowingly cause CBTL to enter into another contract with Smart Plus with an intention to invest the same amount that was promised under the Term Sheet and which amount was not received, if he was of the belief that there was never any intention that this money would be received. To my mind, it does not follow that the respondents knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation. Whilst it is true that the first respondent acknowledged that a resulting claim for damages could arise against Smart Plus from Smart Plus' failure to provide the funds as agreed, it is a basic principle of contract law that once a party breaches an agreement the other party can sue for breach. I agree with Bannister J [Ag.] that the respondents ought not to have allowed the situation to happen. The promises or rather reassurances made by the first respondent as director to fulfil Smart Plus' contractual obligation, without more, do not meet the requirements under section 256.

[58] In **Re Hawkes Hill Publishing Co Ltd (in liq)**[32] the company had experienced cash flow difficulties from early in its inception. An accountant had also advised that the company would need a cash injection as it was operating at a loss. The company eventually went into liquidation. The liquidator brought a claim for wrongful trading under section 214 of the Insolvency Act 1986. He alleged that they (director and secretary) ought to have known (even if they did not actually know) that the company was balance sheet insolvent and could not pay its debts as they fell due. The court had concluded that there had been no wrongful trading on the part of a company secretary and a company director who both had not known or concluded that there was no reasonable prospect that the company could have avoided going into insolvent liquidation, both having thought that the company, which had been incorporated in 1997, could trade its way out of

[32] [2007] BCC 937.

difficulties; the fact that at the end of the first 10 or 11 months of trading the company was not yet solvent did not lead to the conclusion that the directors ought to have concluded that the company would never be solvent or profitable.

[59] In that case, the company was operating at a balance sheet loss, however the company secretary and director were of the opinion that funding could be gained. In the present appeal, there was never any loss in the company, the evidence was the respondents thought that the company's obligations under the contract could be fulfilled. Further, the company was only fixed with a liability (the liability exceeded its assets – it became insolvent) when judgment was entered against it. In my view, this does not satisfy the requirement under section 256. Accordingly, section 256, in the circumstances of this case, is not engaged.

[60] I am not satisfied the respondents knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. The respondents acted within the ambit of the discharge of their duties and responsibilities as a director. Accordingly, they cannot be fixed with personal liability in the circumstances of this case.

[61] This ground of appeal also fails.

Conclusion

[62] Counsel has failed to show that there was a loss suffered by the company and further that there was insolvent trading on the part of the respondents. It is therefore not necessary to deal with the type of relief that should be awarded.

[63] Bannister J [Ag.] was correct in holding that sections 254 and 256 of the **Insolvency Act, 2003** were not engaged. Accordingly, the appeal is dismissed and the decision of the learned judge affirmed.

[64] The delay in the delivery of this judgment is deeply regretted.

Davidson Kelvin Baptiste
Justice of Appeal

I concur.

E. Ann Henry, QC
Justice of Appeal [Ag.]

Ola Mae Edwards
Justice of Appeal [Ag.]