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Challenging Payments made by Insolvent or Near Insolvent Companies

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Introduction

1 It is an honour to contribute this chapter to a publication dedicated to recognising Professor Ian Fletcher and his work. Insolvency law and practice around the world owes a debt of gratitude to his scholarship, vision and diligence in helping to develop the discipline and ensure that it is an area of law that can be regarded as important and critical to commercial decision-making and activity the world over.

Overview

2 When liquidation of a company occurs in England and Wales the liquidator will, like office-holders in most jurisdictions and where many kinds of insolvency regimes are opened, investigate the affairs of the company to which he or she has been appointed very carefully. One of the things that a liquidator will do is to ascertain whether there are any assets or sums of money that could be recovered from directors, associated parties of directors or even parties that are not associated with anyone connected to the company.

3 What will often interest a liquidator and cause further investigation is the payment of sums by the company to others before the advent of the liquidation, on the basis that these sums might be able to be recovered under section 239 of the Insolvency Act 1986 as preferences. But the recovery of sums as preferences is not possible where the conditions for a preference set out in section 239 of the Insolvency Act 1986 ("the Act") are not fulfilled.[1] The liquidator has to establish the following conditions:

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[1] For a detailed discussion of the conditions, see A. Keay, *McPherson's Law of Company Liquidation* (3rd ed) (2013, Sweet and Maxwell, London), at 690-707.

- The transaction was entered into at the relevant time (within the six months before the onset of insolvency[2] or, if the defendant is a person connected with the company, within the two years prior to the onset of insolvency);
- the recipient of the preference is one of the company's creditors or a surety or guarantor for any of the company's debts;
- the company does anything which has the effect of putting the recipient into a position which, in the event of the company entering insolvent liquidation, will be better than the position he or she would have been in had the thing not been done;
- the company was influenced in deciding to enter into the impugned transaction by a desire to enable the recipient to have a preference.[3]

4 It can often be onerous to establish these conditions. Arguably the following are not always easily established:

- The company was at the time of the payment unable to pay its debts;
- The payment was made during the relevant time, namely within the six months before the onset of insolvency or, if made to a connected party within two years of the onset of insolvency;
- The company was influenced in deciding to make the payment by a desire to give a preference to the recipient.

5 The last one is particularly difficult to establish, but if the action is brought against a connected party then the liquidator does not have the burden of establishing it. The burden is on the recipient to prove that the company was not influenced by the relevant desire. Hence, because of this and the fact that there is an extended time period where connected persons are involved, most claims tend to be against connected persons. Besides the fact that the conditions mentioned above might not be able to be established, a liquidator might not wish to take action against recipients of preferences if they are impecunious.

6 An alternative to claiming a preference, where establishing a preference within section 239 is problematic, may be an action against the directors that they acted in breach of their duty under section 172(3) of the Companies Act 2006. If such a claim is made it is against the director and not the recipient of the money. This was the approach taken in *Liquidator of West Mercia Safetywear v Dodd*,[4] where, although the case pre-dated section 172(3), the liquidator claimed that the director of the insolvent company breached his duties to the company in not taking into account the interests of the company's creditors. In this case, it would appear, the

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[2] This term is defined in section 240(3) in relation to straight liquidations is the date of the commencement of winding up. According to section 129, this date is, in relation to compulsory liquidations, the date of the presentation of the petition to wind up.

[3] The elements are discussed admirably by Professor Fletcher in "Voidable Transactions in Bankruptcy Law: British Law Perspectives," in J. Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (1994, Clarendon Press, Oxford), at 307ff. Morritt J, in *Re Ledingham-Smith* [1993] BCLC 635, at 639, discusses the issues which confront a court in a preference case.

[4] (1988) 4 BCC 30.

reason for taking this approach was that a claim against the recipient of a preference might have been worthless as the recipient company was insolvent.

7 For a number of years directors have been under the obligation to take into account the interests of creditors of their company when their company is insolvent or near insolvent. The obligation was first recognised in the Australian High Court decision of *Walker v Wimborne*,[5] when it was said that the directors of an insolvent company in discharging their duty to the company must take account of the interests of its shareholders *and* its creditors, and what the Court had to say on this matter has been applied in a number of common law jurisdictions[6] and many decisions have even extended it. Clearly directors can be subject to the obligation when a company is not insolvent, but in some form of financial difficulty. While the obligation was recognised under the general law, it is now, in effect, codified in the UK in section 172(3) of the Companies Act 2006. Section 172(1) of the Act (which succeeds the duty to act bona fide in the best interests of the company[7]) states that the directors must act in the way that they consider:

> "in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole."

8 Then section 172(3) provides that:

> "the duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

9 Thus, in certain circumstances the obligation in section 172(3) trumps the duty in section 172(1). In this article, I aim to consider the issues that exist when a liquidator cannot pursue, either legally or practically, a claim against the recipient of a payment as a preference, but might be able to bring an action under section 172(3).

The Background to the Obligation

10 While the duty covered by section 172(3), both before and after the advent of the provision, has been shown by the cases to be important, surprisingly the principles relating to it are decidedly skimpy at best. There is uncertainty as to the circumstances which will trigger the obligation contained in section 172(3). The case law does not really provide any detailed guidelines as to when the obligation

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[5] (1976) 137 CLR 1.

[6] For instance, the UK, New Zealand, Ireland.

[7] *Odyssey Entertainment Limited (in liquidation) v Kamp, Timeless Films Limited, and Metropolis International Sales Limited* [2012] EWHC 2316 (Ch)*; Madoff Securities International Ltd (in liq) v Raven* [2013] EWHC 3147 (Comm), at 260.

of directors is triggered. Courts have generally failed to be both consistent and precise.

11 The case law on this subject has developed over the past 30-35 years in several common law jurisdictions and notably in the United Kingdom[8] and Australia,[9] and is applied by the courts in considering section 172(3). The cases provide that if a company is in some form of financial difficulty the directors must consider the interests of creditors in the decisions which they make in running the company's affairs. As mentioned earlier, the seminal decision was *Walker v Wimborne*,[10] where Mason J of the High Court of Australia said that the directors of an insolvent company in discharging their duty to the company must take account of the interests of its shareholders *and* its creditors. This approach was applied by appellate courts in both Australia and New Zealand, and then it was given the imprimatur of the English Court of Appeal in *Liquidator of West Mercia Safetywear v Dodd*,[11] which remains the only appellate decision in the UK that has considered the matter. Largely as far as guidance goes there are many single judge High Court decisions and the decisions of several Commonwealth appellate courts.

12 As to when the obligation arises the following points have been identified by the courts.[12] They possibly fall into five general categories. I do not suggest that these are hard categories at all. It is probably just convenient to see them in this way. First, when the company is insolvent. The determination of whether a company is insolvent is often not an easy task.[13] The problem can be accentuated when the company has contingent or even prospective liabilities. Furthermore, things are made harder where companies are moving in and out of the state of insolvency.

13 The other categories occur before the company becomes insolvent and cover that period that is often known as "the twilight zone". The second category provides that directors can be subject to the obligation when their company is

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[8] For example, see *Liquidator of West Mercia Safetywear v Dodd* (1988) 4 BCC 30; *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218; *Re Pantone 485 Ltd* [2002] 1 BCLC 266; *Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885; *Re MDA Investment Management Ltd* [2003] EWHC 227 (Ch); [2004] EWHC 42 (Ch); [2005] BCC 783; *Re Cityspan Ltd* [2007] EWHC 751 (Ch); [2008] BCC 60; *Re Idessa (UK) Ltd* (sub nom *Burke v Morrison*) [2011] EWHC 804 (Ch); [2012] BCC 315.

[9] For instance, see, *Walker v Wimborne* (1976) 137 CLR 1; *Grove v Flavel* (1986) 4 ACLC 654; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215; (1986) 10 ACLR 395; *Jeffree v NCSC* (1989) 7 ACLC 556; *Linton v Telnet Pty Ltd* (1999) 30 ACSR 465; *Spies v The Queen* [2000] HCA 43; 201 CLR 603; *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239.

[10] (1976) 137 CLR 1, at 7.

[11] (1988) 4 BCC 30.

[12] For a detailed discussion of this, see A. Keay, *Directors Duties* (2nd ed) (2014, Jordans, Bristol), at 378-384.

[13] See the comments of Briggs J. (as he then was) in *Re Cheyne Finance Plc* [2007] EWHC 2402 (Ch); [2008] 1 BCLC 741 and those of the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail – UK 2007-3BL plc* [2013] UKSC 28; [2013] 1 WLR 1408.

nearing,[14] approaching,[15] on the borderline of,[16] or on the verge of,[17] insolvency. Third, where the company is of doubtful solvency.[18] Fourth, where there is a risk of insolvency occurring.[19] Fifth, the obligation can arise if the company is in a dangerous financial position,[20] a parlous financial state,[21] financially unstable,[22] or in financial difficulties (to the extent that the creditors are at risk) and where the state of affairs would endanger creditors' interests.[23] The descriptions of the state of the company in the last category are probably close to the company being of doubtful solvency or being subject to a risk of insolvency. Clearly there are overlaps between the categories. So, the case law provides that directors are to consider the interests of creditors even if a company is in a position short of insolvency. Certainly if a company is insolvent then section 172(3) would come into operation.

14 It is not only the circumstances that trigger the application of the duty that is not precise. It is not altogether clear what directors are to do if subject to the duty. A primary source of assistance is what Leslie Kosmin QC (sitting as a deputy judge of the High Court) said in *Colin Gwyer v London Wharf (Limehouse) Ltd*. He said that in considering the interests of creditors, directors are to take into account the impact of their decision on the ability of the creditors to recover the sums due to them from the company.[24] He also said that if directors fail to take into account creditor interests when they should have done so, then the test provided for in the case of *Charterbridge Corp Ltd v Lloyds Bank Ltd*[25] should be applied with the appropriate modifications for creditors. *Charterbridge Corp*[26] was a case where the judge had to consider the duty of directors to act in good faith in the best interests

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[14] *Nicholson v Permakraft (NZ) Ltd* (1985) 3 ACLC 453 at 459; *Re New World Alliance* (1994) 51 FCR 425 at 444-445; (1994) 122 ALR 531; *The Liquidator of Wendy Fair (Heritage) Ltd v Hobday* [2006] EWHC 5803 at [66].
[15] *Geneva Finance Ltd v Resource and Industry Ltd* (2002) 20 ACLC 1427.
[16] *Eastford Limited v Gillespie, Airdrie North Limited* [2010] CSOH 132, at [22].
[17] *Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885, at 74.
[18] *Nicholson v Permakraft (NZ) Ltd* (1985) 3 ACLC 453 at 459; *Brady v Brady* (1988) 3 BCC 535 at 552*; Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885, at [74]. Also, see the comments of Templeman L.J. in *Re Horsley and Weight Ltd* [1982] 1 Ch 442, at 455.
[19] For example, see *Grove v Flavel* (1986) 11 ACLR 161, at 170; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215, at 223; (1986) 10 ACLR 395, at 404 (agreeing with Cooke J in *Nicholson v Permakraft (NZ) Ltd* (1985) 3 ACLC 453); *Winkworth v Edward Baron Development Ltd* [1986] 1 WLR 1512; *Hilton International Ltd (in liq) v Hilton* [1989] NZLR 442.
[20] *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218, at 228.
[21] *Williams v Farrow* [2008] EWHC 3663 (Ch), at 21.
[22] *Linton v Telnet Pty Ltd* [1999] NSWCA 33; (1999) 30 A.C.S.R. 465.
[23] *Re MDA Investment Management Ltd* [2003] EWHC 227 (Ch); [2004] EWHC (Ch) 42; [2005] BCC 783, at 70; *Re Idessa (UK) Ltd* (sub nom *Burke v Morrison*) [2011] EWHC 804 (Ch); [2012] BCC 315, at 55.
[24] [2002] EWHC 2748 (Ch); [2003] 2 BCLC 153, at 81; 181.
[25] [1970] Ch 62.
[26] Idem.

of their company, in circumstances where the company was solvent. Earlier, in *Re Smith & Fawcett Ltd*,[27] it had been said that directors were obliged to act:

> "bona fide in what they consider – not what a court may consider – is in the interests of the company…"[28]

15 Section 172(1) in effect includes this formula.[29] *Charterbridge Corp* said that where the director against whom proceedings have been initiated had actually failed to consider what would be in the interests of the company, objective considerations apply and the court had to ask whether an intelligent and honest man in the position of a director of the company involved, could, in the whole of the circumstances, have reasonably believed that the action was for the benefit of the company.[30] Hence, applying this to section 172(3), as Leslie Kosmin QC said we should, directors must, in good faith, believe that their actions involve a consideration of the interests of the creditors and if they fail to undertake this consideration then whether or not they would be liable under the sub-section will depend in whether an intelligent and honest person in the position of the directors, could, in the whole of the circumstances, have reasonably believed that the action that is impugned was for the benefit of the creditors.

The Benefits of a Claim under Section 172(3)

16 It is submitted that a claim might be considered under this provision where a preference cannot be established in five types of situations.

> First, where the company was not insolvent when the payment was made. Claims, as we have seen, can be made for breach of section 172(3) when the company was short of being insolvent.
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> Second, the payment to the recipient was made within the six months before the onset of insolvency but the company could not be said to be influenced by a desire to make the payment. Classically, this is where the payment was made because of commercial considerations, e.g. the creditor exerted pressure on the company.[31]
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> Third, the payment was made outside of the six months before the onset of insolvency and made to a non-connected party.
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> Fourth, the payment was made to a connected party, but it was made at a time that was outside the two years before the onset of insolvency.

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[27] [1942] Ch 304.
[28] Ibid., at 306 (per Lord Greene MR).
[29] See *Re West Coast Capital (LIOS) Ltd* [2008] CSOH 72; 2008 Scot (D) 16/5 (Outer House, Court of Sessions, Lord Glennie); *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch).
[30] *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Chapter 62, at 74.
[31] See *Re M C Bacon* [1990] BCLC 324, at 336.

> Fifth, the recipient of the payment cannot be found[32] or is impecunious, and more might be able to be recovered from the directors.

Creditors as a Class

17 A point that seems to favour a claim by a liquidator where a preference-like transaction has occurred is that the case law provides that when section 172(3) applies creditors should be treated as a class, and no creditor within the class should be favoured over others. In *Re Pantone 485 Ltd*[33] the directors of a company in liquidation had disposed of company property without taking into account the interests of one of the creditors, an unsecured creditor entitled to priority in a distribution of the company's assets on a winding up, and when the company subsequently entered liquidation the liquidator brought proceedings against them for breach of duty. While the Court acknowledged that when a company was insolvent the directors had to have regard for the creditors' interests,[34] the claim failed. This was because the directors had a duty to make decisions, when their company was insolvent, while having regard for all of the general creditors, and not one, or a section, of the creditors. Thus, if directors are found, in their consideration of the interests of creditors, that they have favoured one or more creditors within a class, they will have failed to discharge their responsibility.

The Essential Issue[35]

18 So, following on from the last paragraph, if directors discharge the debts of one or two creditors within a class and ignore all of the other debts in that class are they in breach? *Re Pantone 485 Ltd* suggests the answer is "yes". But comments in *GHLM Trading Ltd v Maroo*[36] might suggest otherwise. In that case Newey J was confronted with a claim for a breach of duty where the defendant/director had made a preference type payment. The judge stated that:

> "It seems to me that a company seeking redress in respect of a "preference" to which section 239 does not apply is likely to need to show (a) that it has suffered loss, (b) that the director has profited (so that the "no profit" rule operates) or (c) that the transaction in question is not binding on the company."[37]

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[32] For instance, he or she has left the jurisdiction. See, *Goldtrail Travel Ltd (In Liquidation) v Aydin* [2014] EWHC 1587 (Ch).
[33] [2002] 1 BCLC 266.
[34] Ibid., at 73.
[35] Parts of this section of the chapter are drawn from a part of A. Keay, "Directors' Duties and Creditors' Interests" (2014) 130 *Law Quarterly Review* 443, at 466-470.
[36] [2012] EWHC 61; [2012] 2 BCLC 369.
[37] Ibid., at 169.

19 In this statement the criteria to which the judge refers must exist before, in effect, a breach of duty can be established against a director. No previous decision seems to have taken this course, and his Lordship did not cite authority for the three points mentioned above.[38] Nevertheless, what Newey J said was accepted and applied at first instance and in the Court of Appeal in the Hong Kong case of *Moulin Global Eyecare Holdings Ltd v Lee*.[39] In this case we can see clearly the problems that can occur where certain creditors in a class are paid and others are not paid. Here a director redeemed convertible notes early from two lenders and at a time when the company was insolvent. The redemption involved paying over HKD 98 million, and this left little or nothing for the other unsecured creditors when the company subsequently entered liquidation. It was alleged that the redemption had been effected so as to conceal the true financial situation of the company, and the liquidator brought proceedings seeking to recover the payments made to redeem the notes from the director.

20 Barma J in the Court of First Instance[40] took the view that as the director paid debts of the company when she redeemed the notes there was no loss to the company[41] and so he rejected counsel's argument for the liquidator that the director was in breach. The judge said that the position in the case before him fell outside of any of the three exceptional cases that Newey J referred to in *Maroo*.[42] An appeal from the liquidator to the Hong Kong Court of Appeal was dismissed, the Court agreeing, essentially, with Barma J.[43] I will return to what the Court of Appeal had to say shortly. The liquidator appealed again to the Court of Final Appeal[44] (with the leave of the Court of Appeal) and was partly successful. In his judgment, Gummow NPJ, with whom the other members of the Court agreed, stated that the comments of Newey J in *Maroo*, and quoted above, did not bear directly on the case in *Moulin*.[45] The liquidator was given leave to re-plead his case and although the view taken below on the payment was not disapproved of there were indications in what Gummow NPJ said that the liquidator might succeed at a later date.

21 Earlier, the Court of Appeal court placed emphasis on the fact that, in line with point (a) in Newey J's judgment and quoted above, unless there the company loses out then there can be no breach of duty, and there was no loss to the company as the director merely paid off a couple of creditors. In giving the leading judgment Kwan JA made it clear that any argument that prevented a director paying off a

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[38] Although his Lordship did refer to *Re Brian D Pierson (Contractors) Ltd* [1999] BCC 26.
[39] [2012] HKCFI 989; [2012] 4 HKLRD 263.
[40] Idem.
[41] Ibid., at 25, 37.
[42] Ibid., at 38.
[43] [2012] HKCA 537, at 27.
[44] *Moulin Global Eyecare Holdings Ltd v Lee* [2014] FACV 23 of 2013, 17 July 2014, available at: <http://legalref.judiciary.gov.hk/lrs/common/ju/ju_frame.jsp?DIS=93905&currpage=T> (last viewed 5 November 2014).
[45] Ibid., at 54.

debt conflates the relevant legal principles.[46] One assumes these to be the concept of separate legal entity and the principle that creditors' interests are to be considered when a company is insolvent. The judge said that counsel for the liquidator was trying to argue that the company's interests and those of the creditors were "at one" when a company is insolvent, and they were not.[47]

22 It is surprising that point (a) in Newey J's statement focuses on loss to the company. Certainly as viewed by the Court of Appeal in *Moulin Global Eyecare* "the company" here means the corporate entity. Yet, there are many cases[48] that stand for the proposition that the company is effectively the creditors when the company is insolvent or that there is, at least, a direct connection between the interests of the creditors and the interests of the company at such a point. Thus, the first criterion of Newey J should have been that the creditors must have suffered loss. In *Walker v Wimborne*,[49] Mason J opined that if the directors failed to take into account the creditors' interests that failure will have adverse consequences for the company as well as for the creditors. In *Brady v Brady*[50] Nourse LJ said, in obiter,[51] that when a company is insolvent the interests of the company are in reality the interests of the existing creditors. More poignantly, Richard Field QC (sitting as a deputy judge of the High Court) in *Re Pantone 485 Ltd*,[52] said:

> "where the company is insolvent, the human equivalent of the company for the purposes of the directors' fiduciary duties is the company's creditors as a whole, i.e. its general creditors."[53]

23 Other cases refer to the interests of the company being those of the creditors when the company is insolvent or near to it.[54] Street CJ stated in *Kinsela v Russell Kinsela Pty Ltd*[55] that:

> "They [the creditors] 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

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[46] [2012] HKCA 537, at 26.
[47] Idem.
[48] *Brady v Brady* (1987) 3 BCC 535, at 552; *Re Pantone 485 Ltd* [2002] 1 BCLC 266, at 73; *Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885, at 74; *Re Capitol Films Ltd (in administration)* [2010] EWHC 2240 (Ch); [2011] 2 BCLC 359, at 49; *Re Oxford Pharmaceuticals Ltd* [2009] EWHC 1753 (Ch); [2010] BCC 838, at 92; *City of London Group plc v Lothbury Financial Services Ltd* [2012] EWHC 3148 (Ch), at 54.
[49] (1976) 137 CLR 1, at 7.
[50] (1987) 3 BCC 535, at 552.
[51] Cited in *Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885, at 74.
[52] [2002] 1 BCLC 266.
[53] *Re Pantone 485 Ltd* [2002] 1 BCLC 266, at 73.
[54] *Re Oxford Pharmaceuticals Ltd* [2009] EWHC 1753 (Ch); [2010] BCC 838, at 92; *City of London Group plc v Lothbury Financial Services Ltd* [2012] EWHC 3148 (Ch), at 54.
[55] (1986) 10 ACLR 395.

> of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."[56]

24 Arguably, the judicial comments referred to in the previous paragraphs above are not intended to be interpreted strictly, because if they were they would be denying the concept of separate legal entity. But, on the other hand, the comments could be read without qualification and without any assumption that the judges were ignoring the separate legal entity principle. When dealing with solvent companies English and Commonwealth courts have regarded the company's interests as being the interests of the shareholders. For many years courts have said, in England (and other Commonwealth jurisdictions), when discussing the duties of directors to act bona fide in the best interests of the company as a whole, that the interests of the company in this context refers to the interests of the shareholders. For instance, in *Greenhalgh v Arderne Cinemas*,[57] Evershed MR, with whose judgment the other members of the Court of Appeal agreed, said that the phrase "interests of the company as a whole" did not mean the company as a commercial entity, but rather it meant the corporators as a general body,[58] that is, the shareholders. In *Parke v Daily News Ltd*[59] it was said that the words "benefit of the company" meant the benefit of the shareholders as a general body.[60] Megarry J in *Gaiman v National Association for Mental Health*,[61] said that:

> "it is not very easy to determine what is in the best interests of the [company] without paying due regard to the members of the [company]."

25 His Lordship went on to say that he regarded the expression to mean the interests of present and future shareholders as a whole. In *Kinsela*,[62] Street CJ stated that when a company is solvent:

> "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."[63]

26 So, instead of reading "the interests of the company" meaning the interests of the shareholders, one can read the phrases as meaning the interests of the creditors. Consequently, and in a similar manner, it can be stated that when section 172(3) applies it not possible to consider the interests of the company without considering the interests of the creditors. This is not denying the separate legal entity concept at all, but is recognising reality and the fact that the creditors' interests are critical at this point in the life of the company. Just as the company's interests are aligned

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[56] Ibid., at 401.
[57] [1951] Ch 286.
[58] Ibid., at 291.
[59] [1962] Ch 927.
[60] Ibid., at 963.
[61] [1971] Ch 317, at 330.
[62] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215.
[63] Ibid., at 221.

with the shareholders when a company is solvent, when a company is in dire straits then the interests of the company are coterminous with those of the creditors. If the duty in section 172(3) is to mean anything in relation to creditors as a class then surely payments to some creditors of the same class as others who are not paid must constitute a breach unless the directors can establish that the payments were made with the aim of ultimately benefitting the class of creditors.

27 So for these reasons the opinion provided in the Court of Appeal in *Moulin Global Eyecare* that legal principles were being conflated by the liquidator, is, with respect, taking the conflation point too far. What section 172(1) provides is that the company's affairs are to be conducted in a way that ultimately benefits the members. The obligation in section 172(3) is similar save that the affairs of the company are to be conducted so as to benefit the creditors ultimately, and they are to benefit them as a class. A further point that is to be noted in this respect is that in section 172(1)(f) it is stated that directors must have regard for the need to act fairly as between members, so it could be said that when the directors are obliged to act according to section 172(3), they must have regard for the need to act fairly between creditors; this would involve not paying only a select band of creditors except where it could be said that in making the directors believe in good faith that it will be in the interests of creditors as a class and will benefit the creditors as a whole.

28 Something broadly similar to that which occurred in *Moulin Global Eyecare* occurred in *Bell Group Ltd.*[64] In this case, which was complex and involved a large corporate group, an action had been brought, inter alia, for relief on the basis of breach of directors' duties. The directors of an insolvent company had sought to refinance the company by giving security to banks which were originally unsecured creditors. When the group collapsed there was nothing for general creditors. The judge, Owen J, said that the refinancing action prejudiced the external creditors of the company. His Honour stated that directors were required to take into account the interests of a broader group of creditors than just the banks. He went to say that the company's interests and those of the creditors were separate even when a company was insolvent, but he did say that the interests of the company and the creditors could intersect.[65] Importantly the following point was made by his Honour:

> "It may be, therefore, that in particular circumstances the only reasonable conclusion to draw, once the interests of creditors have been taken into account, is that a contemplated transaction will be so prejudicial to creditors that it could not be in the interests of the company as a whole."[66]

[64] *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239.
[65] Ibid., at 4393.
[66] Ibid., at 4440.

29 John Randall QC (sitting as a deputy judge of the High Court) in *Re HLC Environmental Projects Ltd*[67] said, when confronted with a case where an insolvent company whose directors were subject to section 172(3) only paid some of its creditors, that the defendant/director had breached his duty in choosing which creditors to pay and which to leave exposed to a real risk of not being paid.[68] It is submitted that when a company is insolvent one can say that either the interests of the company are the interests of the creditors and as a class, or else the interests of the company and the interests of the creditors intersect. They both lead to the same result.

30 Also, in *Maroo*,[69] Newey J actually said that where a company is insolvent then the director's duty involves having regard for the interests of the creditors as a class. His Lordship said that:

> "Where creditors' interests are relevant, it will, similarly, in my view, be a director's duty to have regard to the interests of the creditors *as a class*. If a director acts to advance the interests of *a particular creditor*, without believing the action to be in the interests of creditors *as a class*, it seems to me that he will commit a breach of duty."[70] (emphasis added)

31 It must be noted that the issue of "a class" was an important element in the judgment of Newey J for he stated on two occasions in his judgment that directors have to have concern for creditors as a class when insolvency exists.[71]

32 If directors who are subject to section 172(3) pay a sum that prefers one creditor, as in *Moulin Global Eyecare*, it is going to prejudice the creditors in general as there will be fewer funds that are available for distribution. It might be recalled that in *Gwyer*[72] it was said that in taking into account the interests of creditors, directors are to take into account the impact of their decision on the ability of the creditors to recover the sums due to them from the company.[73] Also, Cooke J in *Nicholson v Permakraft (NZ) Ltd*[74] said, in an important decision dealing with the duty to take into account the interests of the creditors, that it is necessary for directors to consider whether what they intend to do will prejudice their company's practical ability to discharge their debts owed to both current and

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[67] [2013] EWHC 2876 (Ch), at 106.
[68] Whilst it might be argued that all of the creditors paid were associated with the director making the payment or the payments benefitted the director either directly or indirectly, the deputy judge did not make any distinction between paying creditors that benefitted the director and paying creditors that did not provide any benefit.
[69] [2012] EWHC 61; [2012] 2 BCLC 369.
[70] Ibid., at 168. Also, see 176.
[71] Ibid., at 168, 173.
[72] *Colin Gwyer v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] 2 BCLC 153, at 74.
[73] Ibid., at 81.
[74] (1985) 3 ACLC 453.

continuing creditors.[75] Arguably any payment of a creditor is likely to prejudice the other members of the class.

33 Of course, a director might argue that a payment is necessary to keep the company's business going and that if the business continues the creditors might end up getting more of their debts repaid. This would then benefit all creditors. If this line of argument has merit, then it would seem that the nature and amount of the payment as well as the position of the company and its expectations, could be of critical importance. Certainly the directors must be able to state that they believed in good faith that the action that they were taking was in the best interests of the creditors.

34 Before paying out any creditors directors must surely first consider how this will prejudice creditors of the same class and then decide whether it is likely to lead eventually to the advantage of the creditors. Directors can surely only be held blameless if they believed in good faith that their action of paying a creditor will benefit the creditors as a class. It is probable that in many cases it will not provide an advantage to the creditors as a class as the payment will be just delaying the inevitable collapse into liquidation, as we see manifest in many of the reported cases.

Conclusion

35 Payments made by companies to creditors before they enter liquidation are usually examined carefully by liquidators to see if they can be challenged. Generally, they are attacked as preferences, but if the conditions set out in section 239 are not able to fulfilled a liquidator has to consider another approach. If a payment is made to a creditor by a company when insolvent or in financial difficulties and it is not a preference within section 239 it might be possible for a subsequently appointed liquidator to bring successful proceedings against the directors for breach of their duty under section 172(3) provided that the payment was made to a member of a class of creditors that claim in the winding up and it could not be said to be an action that the directors believed, in good faith, to be one that would benefit the creditors as a class.

[75] Ibid., at 459.

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