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UPDATE

BVI Court of Appeal upholds 'Creditor Duty'

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In *Byers & Richardson v Chen Ningning* (BVIHCMAP 2024/0009), the BVI Court of Appeal has reaffirmed the principle that in circumstances where a company is insolvent, or on the verge of insolvency, the fiduciary duties owed by the directors to the Company are also owed to the creditors. A director in breach of those duties may be held personally liable – even where the transactions concerned appear to be balance sheet neutral.

The 'Creditor Duty'

Directors have a duty to consider the interests of company's creditors when a company is insolvent or is about to become insolvent. It stems from the overarching fiduciary duty of directors to act in good faith in the best interests of the company, which extends to the interests of creditors as a whole when the company is approaching insolvency or is insolvent. This principle was first established in *West Mercia Safetywear Ltd (in liq) v Dodd and another* [1988] BCLC 250 and has become known as the 'rule in *West Mercia*'. The rule in *West Mercia* was confirmed by the United Kingdom Supreme Court in *BTI 2014 LLC v Sequana SA* [2022] UKSC 25.

Background to *Byers v Chen Ningning*

The respondent, Ms Chen Ningning (**Ms Chen**), was the sole director and ultimate beneficial owner of a company called Pioneer Freight Futures Ltd (**PFF**). PFF entered into a loan agreement with Zenato Investments Ltd (**Zenato**) by which Zenato lent US$13m to PFF. In November 2009, whilst in a state of insolvency, PFF repaid the loan to Zenato in three separate tranches.

The appellants, as the joint liquidators of PFF, brought a claim in the BVI Commercial Court against Ms Chen for causing or authorising the payments to Zenato in breach of her fiduciary duties as director of PFF, by favouring one creditor over the general body of creditors. The matter was ultimately appealed to the Privy Council. The Privy Council found that Ms Chen remained a *de jure* director during the relevant period and as such had breached her fiduciary duties to PFF by failing to intervene and/or prevent the payments to Zenato. The matter was remitted back to the High Court to determine the financial consequences of that breach. The High Court, after considering the rule in *West Mercia*, held that the payments to Zenato were balance sheet neutral, PFF did not suffer a net loss, and as such no compensation was required to be paid by Ms Chen. The appellants appealed to the Court of Appeal.

On Appeal

The Court of Appeal overturned the High Court's decision, finding that:

- Applying the rule in *West Mercia*, once a company is insolvent or bordering on insolvency, the interests of the company for the purposes of the director's fiduciary duties are extended to include the interests of the company's creditors as a whole.
- In determining the loss caused by a breach of the rule in *West Mercia*, any loss to the general body of creditors must be equated with that of the company. Directors would otherwise be encouraged to act in breach of the rule, knowing that once the transaction is balance sheet neutral, the company would suffer no financial loss and consequently the directors would not be held liable.

- Any financial benefit to the director is not a relevant consideration in determining whether the company suffered any loss because of the director's breach of the rule in *West Mercia*.
- The High Court was wrong to determine that the only eventual basis for making a payment order was what PFF needed to be compensated for a net loss incurred because of the payments to Zenato and since there was no such net loss to PFF, no compensation fell due. In making the payments to Zenato, the company suffered a pecuniary loss equivalent to the financial loss suffered by the general body of creditors.

Ms Chen was ordered to pay the sum of US$13m, together with interest to the appellants. The Court of Appeal directed that in the distribution of PFF's assets to the general body of creditors the debt due to PFF is to be taken as notionally increased by US$13m to what it would have been if the payments to Zenato had not been made, and any dividend attributable to the additional US$13m is to be recouped to Ms Chen rather than being paid back to PFF.

Conclusion

The decision reinforces the importance of the rule in *West Mercia* and will be of particular interest to insolvency practitioners and directors alike. The decision highlights the court's readiness to provide effective remedies for breaches of duty, ensuring directors cannot shield behind accounting formalities when company creditors are prejudiced. Payments made in breach of the rule in *West Merica* that reduce the distributable pool of assets for the general body of creditors may trigger personal liability of the director.

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