CASE REVIEW SECTION

The Recognition of Directors Owing Fiduciary Duties to Creditors – *Re Pantone 485 Ltd* and *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*

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The question of whether directors owe fiduciary duties to creditors when the company is insolvent or of doubtful solvency now seems beyond doubt. Dicta supporting such an extension of directors duties now spans some twenty years. For example, in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 the Court of Appeal, citing with approval the decision of the New South Wales Court of Appeal in *Kinsela v Russell Kinsela Pty Ltd* (1986) 10 ACLR 395, held that shareholders cannot absolve directors from a breach of duty to creditors so as to bar the liquidator's claim. Of particular note in Dillon LJ's view was the following passage from Street CJ's judgment in *Kinsela*:

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

The recognition of the existence of directors' duties to creditors has received the endorsement of the House of Lords. In *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, Lord Templeman explained that directors owe a fiduciary duty to the company and its creditors, present and future, to ensure that its affairs are properly administered and to keep the company's 'property inviolate and available for the repayment of its debts' (see also, *Lonhro Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627 HL, at 634 per Lord Diplock).

Set against this landscape the decision in *Yukong Line Ltd of Korea v Rendsburg Investment Corpn of Liberia (No 2)* [1998] 2 BCLC 485 was timely in pointing out that creditors have no standing, individually or collectively, to bring an action in respect of any such duty. Toulson J held that a director of an insolvent company who, in breach of duty to the company, transferred assets beyond the reach of its creditors owed no corresponding fiduciary duty to an individual creditor of the company. The appropriate means of redress was for the liquidator to bring an action for misfeasance (the Insolvency Act 1986, section 212).

Notwithstanding the logistical issue of *locus standi* raised by Toulson J, the question of directors' duties to creditors again emerged in two recent decisions of the Companies Court. In *Re Pantone 485 Ltd* [2002] 1 BCLC 266, Richard Reid QC, sitting as a deputy judge in the High Court, observed that:

> In my view, 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. It follows that if the directors act consistently with the interests of the general creditors but inconsistently with the interest of a creditor or section of creditors with special rights in a winding-up, they do not act in breach of duty to the company.

In *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153, it was held that a resolution of the board of directors passed without proper consideration being given by certain directors to the interests of creditors would be open to challenge if the company had been insolvent at the date of the resolution. Leslie Kosmin QC, sitting as a deputy judge in the High Court, stated that in relation to an insolvent company, the directors, when considering the company's interests, must have regard to the interests of the creditors. The court was required to test the directors' conduct by reference to the *Charterbridge Corp Ltd v Lloyd's Bank Ltd* [1970] Ch 62 test, *ie.* 'could an honest and intelligent man, in the position of the directors, in all the circumstances, reasonably have believed that the decision was for the benefit of the company'. In the case of insolvent companies the test is to be applied with the benefit of the creditors substituted for the benefit of the company.

Whether or not creditors need the additional protection of fiduciary duties is questionable given the fraudulent trading and wrongful trading provisions contained in the Insolvency Act 1986 together with section 212 (misfeasance proceedings) of that Act. Further, despite the judicial creativity seen above, it is noteworthy that the Government in its 2002 White Paper rejected the Company Law Review Steering Group's recommendation that the proposed statutory statement of directors' duties should include a direct reference to creditors (see *Modernising Company Law*, Cm 5553-1, paras 3.8-3.10). These points aside, while it now appears settled that directors of insolvent or prospectively insolvent companies owe duties to creditors, the relevant decisions do not lay down any guidance as to when directors should shift their attention away from the company *qua* body of shareholders towards the interests of its creditors. Clearly this depends upon the company's solvency. But identifying the point in time when a company is insolvent (*ie.* when debts cannot be met) is, in practical terms, fraught with difficulty (see the Cork Report, Cmnd 8558 (1982)).

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