



## Directors need to consider their fiduciary duties when taking risks

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In the matter of *Henry George Dickinson v NAL Realisations (Staffordshire) Limited & Others [2017] EWHC 28 (Chancery)*. This case concerns a company called Norton Aluminium Ltd which operated an aluminium smelting foundry in Staffordshire. It went into administration in August 2012 following the circulation of a draft judgment by which HHJ McKenna upheld in part claims in nuisance brought against it by a group of local residents. It subsequently entered liquidation.

The claimant was the managing director and controlling shareholder of the company who brought a claim against the liquidators to recover sums totalling some £1m which he claimed were secured by a debenture over the company's assets.

The liquidators brought various counterclaims, seeking to avoid or recover compensation for a number of transactions instigated by the claimant, namely:

- The transfer of the company's factory premises to the claimant'
- The sale and purchase back of most of its shares from the claimant for £2.5 million, which was left outstanding as a secured loan'
- The sale of a subsidiary company to the claimant for £1, alleged to have been at an undervalue; and
- Loans and supplies made on credit by the company to a related company in India, which had issued shares to the claimant (which were paid for out of the proceeds of the share buy-back) which made him majority shareholder.

Claims were made pursuant to s.423 of the Insolvency Act 1986 in relation to these transactions. It was alleged that the claimant preferred his own interests over those of the company and that the share buy-back and the sale of the subsidiary were transactions at an undervalue; alternatively, those transactions were voidable for lack of proper authorisation

In addition, the liquidators claimed that the transactions formed part of a scheme to prevent the local residents, who at the relevant time were merely threatening to bring a claim, from receiving anything from the company if they were successful. By doing so it was alleged that he was acting in breach of his fiduciary duty to consider the interests of the creditors.

### Judgement of HHJ Cooke

In relation to the sale of the company's factory, the Court found that this was not approved by the directors pursuant to a valid resolution. As such it was held that the purported agreement was prima facie void and the claimant held the property on trust and was liable to restore it to the company.

The Court rejected an application that the claimant should be relieved of liability pursuant to section 1157 of the Companies Act 2006 on the basis that it could not be said that he had acted "*honestly and reasonably*" and there was no indication as to what benefit the company obtained by selling its premises.

The Court also found that the share buy-back was void as it was not in compliance with the Companies Act 2006.

It further held that claimant's objective in entering into the buy-back transaction was to reduce the net asset value of the company and ensure that his interests ranked ahead of those of the environmental claimants. That was the inescapable inference to be drawn from the fact that the scheme was embarked upon when it seemed that the environmental claim was becoming more real and was unlikely to be covered by insurance. Converting the rights of shareholders into claims for secured debt prejudiced the interests of the environmental claimants by increasing the pool of liabilities competing with their claim and putting assets beyond their reach by ensuring that the shareholders' debt had a prior claim on the assets. Accordingly, the buy-back fell within s.423 as a transaction defrauding creditors.

However, the claimant's extraction of £2.5 million of net assets at the time of the buy-back did not place the company on the verge of insolvency, as it was trading successfully at the time and had ample capital and liquidity to continue doing so.

Whilst directors are not free to take action which puts at real (as opposed to remote) risk the creditors' prospects of being paid, without first having considered their interests rather than those of the company and its shareholders, HHJ Cooke found that the authorities did not justify a finding that the general duties of directors required them to give priority to the interests of creditors simply because there was a recognised risk of adverse events, such as the environmental claim that might be lost and result in a large liability leading to insolvency.

It was held that the claimant reasonably took the view that the prospects of an eventual complete or virtually complete victory were good. HHJ Cooke added:

*"There was a real risk of insolvency if the claim was lost and resulted in a large liability, but also a real prospect that it would never become insolvent. The claims may very well have been defeated. Although the amounts sought were very high, it was not an all or nothing situation- there was a real prospect that even if some part of the claims succeeded the liability would be affordable. In that situation, the company would have been solvent in that it could have paid the liability ..."*

In relation to the transfer of the shares in the subsidiary company for £1 this was held to be a transfer at undervalue for the purposes of s.423.

Finally, with reference to the transactions entered into with the Indian company, the Court found that there was no evidence that the investment was not a bona fide commercial transaction; therefore, it could not be classed as amounting to a preference.

The claimant's claims were also dismissed with the result that any claims he had were unsecured and several of those claims fell away.

## Summary

The liquidators counterclaim largely succeeded and the Court upheld the claims made pursuant to s.423.

However, the claim for breach of fiduciary duty as regards the interests of creditors did not succeed.

When considering whether the directors of a company in liquidation are in breach of their fiduciary duties, the general duties of company directors are not such as to require them to give priority to the interests of creditors simply because, at the time of entering into a transaction during the company's solvency, there was a risk of adverse events that might result in a large liability leading to insolvency.

The team at Blake Morgan LLP has extensive experience of advising Directors of their duties. If you'd like to discuss a specific issue or case please call 029 2068 6199 to speak to Delme Griffiths or call 029 2068 6181 to speak to Paul Caldicott.



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