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WEST MERCIA AND DIRECTORS' DUTY OF CARE

For the second time in less than three months, the Supreme Court has considered the nature of directors' duties to creditors as insolvency looms.

Stanford International Bank ("Stanford") was a Caribbean based bank which entered into liquidation in 2009. Stanford offered certificates of deposit at rates significantly higher than US based banks. In February 2009 the US Securities and Exchange Commission ("SEC") charged members of Stanford's investment committee with fraud. The SEC stated that the bank had operated "a massive Ponzi scheme", misappropriating billions of dollars of investors' money and falsifying records to cover the fraud. Stanford's high-profile owner, Allen Stanford, is currently serving a US prison term of 110 years.

The *Quincecare* duty of care requires a bank to exercise reasonable care and skill and puts a bank on enquiry if an instruction looks to be an attempt to misappropriate funds. However the courts have interpreted that duty as very narrow and case specific, so much so that on only one occasion has a bank been found liable.

In *Stanford International Bank Ltd v HSBC Bank Plc [2022] UKSC 24* Stanford had claimed against HSBC for breach of the *Quincecare* duty. The Supreme Court had to determine whether, on the assumption that there had been a breach by HSBC of the *Quincecare* duty, Stanford had, in fact, not suffered any loss. [Applying the same assumption, the Court of Appeal had earlier held that Stanford had not suffered any loss under "the net loss principle" since the payments had discharged genuine creditors and so there was, overall, no change in Stanford's net liabilities].

HSBC paid out £116 million on the instructions of Stanford which were contractually due but after a time when it was alleged HSBC should have been aware of the fraud. The Supreme Court distinguished between two sets of customers. First, those who had escaped without loss because they had withdrawn their funds prior to the collapse of Stanford ("the Early Customers"). Second, those

who had not withdrawn their funds and so risked losing almost all of their money ("the Late Customers").

Stanford changed tack in the Supreme Court and argued that whilst there had been no loss under "the net loss principle", there had been a "loss of chance". If the Early Customers had not been paid out at 100 pence in the pound, then there would have been an additional sum of £116 million available to distribute amongst one pool of creditors in the liquidation estate. [All the customers would have received about 12 pence in the pound rather than the Early Customers getting 100 pence and the Late Customers only 5 pence].

The Supreme Court held by a majority that Stanford was in no worse a position than if the payments had not been made. The payments did not increase Stanford's liabilities and thus did not make Stanford's net asset position any worse. There was therefore no recoverable loss for which HSBC could be held liable.

The Supreme Court acknowledged that its decision was harsh on the Late Customers. However, the Court stated that the fairness or unfairness of the payments is not a matter that the court could investigate or assess but was a matter of statutory policy within the insolvency regime.

Editor's Note

Good news! The Supreme Court distinguished the situation of malfeasant directors who, in breach of their fiduciary duties, paid certain creditors as a preference. In the leading case of *West Mercia Safetywear Ltd (1988)* a director, who knowing that his company was insolvent, had deliberately paid off a debt which he had guaranteed. This director had similarly argued that he should not be liable as the company had suffered no loss under "the net loss principle". However, the nature of the duty owed by a director to the general body of creditors upon a company's impending insolvency continued to apply and is entirely different from a bank's *Quincecare* duty solely to its customer.



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