[2024 Gib LR 85]

FLOWERS v. ENTERPRISE INSURANCE COMPANY PLC (in liquidation)

COURT OF APPEAL (Kay, P., Elias and Rimer, JJ.A.): April 4th, 2024

2024/GCA/005

Companies—directors—powers and duties—director of insurance company acted dishonestly and in breach of fiduciary duty and duty of care in respect of triangular arrangement whereby money paid by insurance company to sister company pursuant to marketing services agreement, although no services in fact provided, money then transferred to holding company, which paid some moneys to director and others, and then used remainder to provide capital to insurance company—arrangement designed to siphon money from insurance company and circumvent regulatory controls—no ratification by company

Companies—directors—powers and duties—director breached common law duty to exercise reasonable care and skill in writing insurance policy in respect of Icebreaker tax avoidance scheme

The respondent brought proceedings against the appellant for breach of fiduciary duty and breach of duty of care.

The respondent ("EIC") was an insurance company which went into insolvent liquidation in 2016. EIC, acting by its liquidator, took proceedings against, *inter alios*, eleven directors. These had been settled against all directors except the appellant. The appellant was the major figure behind the Enterprise group. He was a director of EIC; its holding company, Enterprise Holdings Ltd. ("EHL"); and another subsidiary, EIG Services Ltd. ("EIG").

It was alleged that the appellant had acted in dishonest breach of his fiduciary duties towards EIC, in particular by securing that EIC paid money to EIG for services allegedly provided by EIG pursuant to a marketing services agreement ("MSA") when in fact, to the appellant's knowledge, no services were provided. Pursuant to the MSA, EIC paid EIG a fixed commission of 8% of its gross written premium. EIG transferred part of those sums to EHL, which in turn used part of that money to provide capital to EIC, generally in return for shares in EIC. Neither company was under any obligation to EIC to take those steps. From 2004 to 2016, EIC paid out some £50m. and received back from EHL some £33m. EIC also received rebates from EIG with respect to PIE payments of around £12.4m. (From 2004 to 2012, EIC paid EIG for the use of the PIE system, which was software which facilitated the selling of "after the event" insurance policies. The liquidator claimed there was no proper rationale for any of these payments and that the true purpose was to release cash from EIC.) The liquidator alleged that the MSA was a sham and that no services had been provided by EIG under it. It was alleged that the appellant had dishonestly and in breach of his fiduciary duty as director of EIC allowed money to be diverted from EIC in breach of the terms of its licence, partly to benefit himself. EIG paid substantial sums to the appellant and another shareholder of EHL, which were ostensibly consultancy and directors' fees.

The appellant claimed in his defence to the alleged breaches of duties that his conduct had been ratified by the unanimous approval of all the shareholders but the liquidator claimed that EIC had been insolvent since June 30th, 2010 and that any payments made by EIC to EIG after that date could not lawfully be ratified. It was alleged that the appellant knew or ought to have known of EIC's insolvency and that he was in breach of the duty he owed to the creditors. He could not therefore succeed in arguing that any breaches of duty had been ratified because shareholders could not ratify a breach of duty not owed exclusively to themselves.

It was also alleged that the appellant had been negligent in allowing EIC to enter bespoke insurance policies in relation to a scheme known as "Icebreaker." EIC wrote some 400 policies with respect to "Icebreaker 2" which was a complex tax avoidance scheme designed to secure tax advantages for investors who joined the scheme. The Icebreaker schemes involved making investments in the arts sector through an LLP of which an investor became a member. The reason for investing through an LLP was that, provided it was carrying on a trade, profession or business "with a view to profit," the activities of the LLP were for tax purposes treated as carried on by the members. The members could then take advantage of the arrangement that losses could be set off against other independent gains ("sideways loss relief") provided they satisfied certain requirements. The scheme was based on the premise that there would be losses in the first year. The claim for losses incurred would be made by the LLP in its tax return for that year. They would only be permitted if the losses were incurred wholly and exclusively for the purposes of the partnership's trade. The individual member would then claim sideways relief based on his or her share of the loss, the amount being determined by reference to the losses which HMRC had allowed the partnership to claim.

The insurance policy effectively guaranteed the policyholder a return of the policyholder's investment (*i.e.* the full capital contribution minus the loan) at the end of five years, adjusted for any profits received from the LLP. EIC was off risk if either (i) at the end of five years the member's proceeds from the investment equalled or exceeded the insured amount; or (ii) HMRC agreed, or a relevant court or tribunal finally determined, that the first-year trading losses of the LLP were allowable for tax purposes and that the LLP's tax return for the relevant year was correct. Clause 11.4 of the policy provided a potential defence to any liability:

> "The Insurer shall have no liability to the insured under his Policy where the Insurer reasonably believes, and has reasonable grounds for his belief, that the LLP and the Insured have colluded in an attempt to engineer the failure of the LLP leading to insufficient income being generated causing a claim to arise on this Policy."

In respect of the possibility of HMRC approval, the appellant relied on the advice of a leading tax barrister. Subsequently Icebreaker 2 was the subject of legal proceedings. The investment was found not to be a commercial venture, which was a condition precedent to the entitlement to sideways loss relief.

In the Supreme Court, Restano, J. upheld the liquidator's claims. With respect to the MSA, he held that the appellant had acted in breach of both his fiduciary duty and his common law duty of care. To the appellant's knowledge, EIG had provided no services to EIC and in effect EIC simply gave money to EIG allegedly under the auspices of the MSA but in fact for no benefit whatsoever. The payment to the appellant of over £6m. ostensibly for consulting work was held to be a disguised dividend from EIG which could not have been paid had EIC complied with the regulatory safeguards. The real purpose of the arrangement was to enable the appellant to extract money from EIC in a way which could not possibly be said to be in its interests. It was also dishonest. The judge held that matters could not be ratified. First, as a matter of fact there was no informed consent. The shareholders would have needed to know that no services were provided by EIG for the sums received from EIC and that the PIE payments were excessive. Since the appellant had sought to argue to the contrary, there was no evidence that the shareholders did know this. Secondly, EIC had been insolvent since June 30th, 2010 and the appellant either knew or ought to have known that this was the case. It followed that the duty to have regard to the interests of creditors arose at that time, and there could be no ratification of any payments made thereafter. With respect to the creditor duty, Restano, J. held that the appellant was in breach of that duty also, at least from when EIC became insolvent. With respect to Icebreaker, the judge found that the appellant had negligently failed to take advice about the risks involved in the scheme, although he acquitted the appellant of having acted in breach of fiduciary duty. As a result, the reserves entered into the accounts for these policies were wholly inadequate. Although there was an unearned premium reserve which catered for the possibility that part of the premium might have to be returned if the policy were cancelled before it was due to expire, there was no reserve to cover potential liabilities under these policies. In concluding that the appellant had been negligent, the judge rejected the two defences to claims under the policies (cl. 11.4 and public policy).

The appellant appealed. In relation to the judge's finding that he had acted in dishonest breach of his fiduciary duties towards EIC, in particular by securing that EIC paid money to EIG pursuant to the MSA, he submitted *inter alia* that (a) EIG performed services under the MSA and the judge was wrong to find otherwise; (b) in determining whether there was a breach of the duty of good faith, the judge had failed to recognize the true significance of the arrangement. He had not given any weight to the fact that it was the principal objective of the arrangement that a substantial part at least of the moneys paid out by EIC should be returned in the form of capital, which was vital to enable it to develop its business; (c) even if the judge were entitled to find that there were no services provided for the 8% fee, this was immaterial. The real purpose of the MSA had always been to facilitate the introduction of capital into EIC and circumvent the borrowing constraints on insurance companies, which had been achieved; (d) it was irrelevant whether the operation had the sanction of the regulator or involved a breach of any obligations imposed by the regulator; (e) the capital returned to EIC in the form of reimbursements from EIG with respect to the PIE payments and regular capital injections by EHL virtually matched the sums paid out to EIG; (f) the fact that others, including the appellant himself, had also benefitted from the arrangement did not render it unlawful or improper. The only question was whether the application of the triangular model benefitted EIC; and (g) contrary to the judge's finding, the Gibraltar Financial Services Commission had been fully aware of how the arrangement was working and had raised no objection to it.

In relation to the issue of loss arising from the breach of fiduciary duty, the appellant submitted *inter alia* that payments to EIC by EHL for shares in EIC and start-up capital should be credited against its loss.

In relation to the judge's finding that the appellant breached his common law duty to exercise reasonable care and skill when he wrote the Icebreaker business on behalf of EIC, the appellant denied that he was negligent and submitted that there was in fact no risk of any liability arising under the policies, but that even if there were, he had acted reasonably on legal advice. Properly analysed, both cl. 11.4 and the defence of public policy defeated any claims under the policy and the judge ought to have so concluded.

In relation to the judge's finding that the appellant breached the creditor duty on the grounds that he knew or ought to have known that EIC was insolvent from June 30th, 2010, the appellant challenged the evidence for EIC. It was submitted that it was not good enough simply to make a calculation of assets and liabilities as a snapshot at a particular time and to assume that because there was an excess of liabilities, a company must be insolvent. There had to be a careful analysis of when liabilities would become due and whether by then the company might be in a position to pay them. It should have been recognized that historically when EIC had been close to insolvency, a capital investment had been made, but EIC's expert had made no allowance for this possibility. It was inappropriate for the liquidator simply to rewrite the balance sheet without any reference to, or consideration of, the accounts approved by previous auditors. The starting point should have been that their audits were appropriate, at least unless there were strong reasons to think otherwise.

The appellant also raised various complaints about the way in which the judge dealt with procedural issues which arose in the course of the trial. Most fundamentally, it was submitted that it was unfair for the trial to have gone ahead once the appellant had dismissed his counsel, some five days into the trial, for financial reasons. He also made other complaints about what he alleged were procedural failings by the judge, such as the way in which the judge dealt with the statements of witnesses who were not in the event called to give evidence, including Mr. Newing who had been EIC's finance director.

Held, judgment as follows:

(1) The appeal against the judge's findings with respect to MSA, PIE and related matters would be dismissed. The judge was entitled to conclude that the appellant acted dishonestly and in breach of his fiduciary duty to act in the best interests of EIC and also acted in breach of his duty of care. The core duty underpinning a director's duty of loyalty to a company was that the director must act bona fide in the interests of the company. It was a subjective duty. Where a director simply failed to address whether a course of action was in the best interests of a company at all, the subjective test could not then be adopted and in those circumstances there would be an objective test as to whether an intelligent and honest man in the position of a director of the company concerned could, in the circumstances, have reasonably believed that the transactions were for the benefit of the company. The directors of a company in a group could not act in a way that was to the detriment of that company, however beneficial it might be to the group as a whole. An objective test applied when assessing dishonesty, namely whether a reasonable person in the position of a defendant would consider his conduct honest. The test was applied to the facts as understood by the defendant. Any director in breach of the subjective duty of good faith would be acting dishonestly since he would not honestly believe that he was acting in the interests of the company. The judge was fully entitled to conclude that EIG provided no services pursuant to the MSA. The staff were only formally employed by EIG; in reality they worked for EIC. There was no evidence of any marketing work which might justify the fee claimed, and no evidence of any other services provided. There was also contemporaneous documentary evidence that the appellant and Mr. Newing did not believe that EIG was providing services to EIC pursuant to the contract. This was not to say that EIG did nothing at all for EIC. It did make its staff available and at least from 2013 (backdated to 2011) it paid for them itself. However this did not materially help the appellant's case. The provision of staff might conceivably have justified some sort of fee over and above the actual salaries involved, but only if EIG, as opposed to EIC, could be said to have actively administered the staff's contract and related employment rights, which seemed doubtful. In any event, these were not services pursuant to the agreement and they were not the services relied upon to justify the payments. Moreover, it was difficult to see how there could be any justification for paying a fixed 8% for any such service,

which would be a gross overpayment. The triangular arrangement was far removed from a legitimate agreement where services were provided for fees paid. It was highly relevant that the arrangement was carried out in breach of EIC's obligations to the Commission. The Commission would not have permitted the arrangement had it appreciated its true nature. Further, the submission that the principal purpose was to facilitate the growth of capital to enable the company to develop was at odds with the judge's justified finding that the aim was to siphon money from EIC to enable it to be used for a variety of purposes some of which were wholly unrelated to any benefit to EIC, including enabling both EHL and its shareholders, which included the appellant, to receive payments which the judge found were akin to dividends, thereby circumventing the regulatory controls imposed by the Commission. The argument that there was no loss was irrelevant to the question of whether there was any breach of fiduciary duty. The fact that capital was paid back into the company might be material to the question of whether the defendant acted genuinely in good faith and therefore to the related question of dishonesty, but it was not sufficient to absolve the appellant of the finding that he was in breach of his fiduciary duty with respect to the operation of the MSA. The judge also found that the appellant was in breach of his duty of care to the company. The court would uphold that finding but in practical terms it added nothing to the finding on fiduciary duty (paras. 36–46; paras. 82–119).

(2) The appellant's submission that the unlawful acts either had been ratified as a matter of fact or could in the circumstances be ratified as a matter of law would be dismissed. EIC had not passed a resolution ratifying the appellant's conduct. A formal resolution was not required if there was the unanimous informal consent of all the company's shareholders. The giving of consent was conditional on the members being fully informed of the breach. They had to be aware of at least the material facts which were necessary to enable them to take a considered view on whether they were willing to approve or accept the transaction in question and adopt it on behalf of the company. Not all breaches of duty could be ratified. Ratification could only apply to *intra vires* acts in the broad sense of acts which the company was entitled to perform. An act could not be ratified if it was dishonest or if it was in breach of a duty owed to creditors. In the case of the breaches of duty owed to EIC, there was only one shareholder, EHL. There was no board resolution and the directors could not be said unanimously to have approved the breaches of duty. They were not properly informed of what they were supposed to be ratifying and not all directors gave evidence at trial. Secondly, the finding of dishonesty meant that the payments made from EIC to EIG were not ratifiable breaches of duty. It was also arguable that the company could not ratify because it could not itself lawfully have made the payments. However the court rejected the judge's conclusion that one of the reasons why ratification was not possible was that the appellant ought to have known that EIC was insolvent from June 30th, 2010, with the consequence that unlawful transactions were not thereafter ratifiable by the shareholders (paras. 120–129; paras. 133–138).

(3) In relation to the issue of loss arising out of the breach of fiduciary duty, the court upheld the appeal against the judge's refusal to set off the payments made by EHL to EIC for shares in EIC against the losses resulting from the breach of fiduciary duty. The general rule was that where a claimant had received some benefit attributable to the events which caused his loss, it must be taken into account in assessing damages unless it was a collateral benefit (*i.e.* a benefit whose receipt arose independently of the circumstances giving rise to the loss). The payments were directly attributable to the events causing the loss, *i.e.* the unlawful payments made indirectly to EHL. The payments were a feature of the triangular model, although there was no legal obligation binding EHL to pay anything into EIC. EHL was the sole shareholder of EIC and the addition of further shares gave it nothing of substance. It was merely an accounting device. The fact that shares were received simply diluted the value which EIC's shares would otherwise have had. The payments increased the value of EIC and thereby reduced the amount of loss suffered from the MSA and PIE payments. Equitable compensation was designed to make good any loss suffered and it would be inequitable to fail to give credit for these payments. The court did not, however, accept that the start-up capital which was introduced into EIC by EHL before EIC started to trade should also be set off. The start-up capital could not be a credit with respect to moneys wrongfully taken out subsequently. When the loans were taken out it might well have been anticipated that sums would be raised through the triangular model to pay for them. But it would not have been known, either when the payment was made or the loan was secured, that the model would be used in an abusive way and that no services would be provided for the payments to EIG. These were not therefore benefits which were attributable to events which caused the loss (paras. 142–152).

(4) The appeal against the judge's finding that the appellant breached his common law duty to exercise reasonable care and skill when he wrote the Icebreaker business on behalf of EIC would be dismissed. The judge rejected the appellant's evidence that he understood the scheme to be a genuine investment scheme rather than a tax avoidance scheme and that the loan was going to be invested. In the light of powerful evidence—including the Icebreaker documents, which made it clear to investors that the loan was not being invested, and documents produced by the appellant stating that Icebreaker 2 was a tax scheme—there was no ground for challenging the finding by the judge. In any event, whether or not this was the appellant's genuine belief, the judge held that it was negligent not to read the basic scheme documents properly before issuing the policies. The judge also considered that the appellant ought to have taken advice as to the nature of the investments and their likely returns. Given the judge's finding that the appellant had appreciated that the loan was not to be invested, it was wholly fanciful for him to believe that the LLP would generate profits sufficient to enable the investors to receive back from the LLP the insured amount. So far as the possibility of HMRC approval was concerned, the appellant said that he had relied on the advice of a leading

tax barrister who had given a number of opinions in which he apparently expressed the view, with respect to Icebreaker 1, that the scheme should receive Revenue approval. In that event, EIC would be off risk. However, as the judge pointed out, it was known even before any Icebreaker 2 policies were issued that the Revenue was disputing that sideways loss relief was applicable, and therefore counsel's opinion had to be treated with caution. The appellant said that he understood that Icebreaker 2 had removed some of the problems of Icebreaker 1, but the judge observed that it was negligent not to obtain advice as to that. Even if the appellant was initially confident that tax relief would apply, he could not properly adhere to that view in the light of the subsequent cases. He ought therefore to have revisited the question of risk and reserves in the light of these developments. It ought to have been obvious at a relatively early stage that there were considerable risks in underwriting the Icebreaker 2 policies. There was no realistic chance that EIC would be off risk on the basis of investment returns, particularly given that the loan was not invested; and there was from the beginning considerable doubt—which subsequently proved well-founded—whether HMRC or the courts would accept that the schemes attracted sideways loss relief. The only basis on which the directors could in good faith have concluded that there was no risk, and therefore no need to make any reserves for potential liabilities, was if they believed that there was a very strong defence to any liability. The appellant placed considerable weight on cl. 11.4 but the judge did not accept that the appellant could reasonably have believed that the clause had the effect he claimed. The judge found that proper instructions had not been given to the Gibraltar counsel who drafted the clause. Moreover, the judge noted that the clause made no reference whatsoever to the fact that the policy would only apply if the whole capital contribution, including the loan, was invested. Nor did it refer to the need for the policyholder to be a "genuine investor." Finally the appellant also relied on the fact that, after it was held that the scheme did not secure the relevant tax relief, he had taken further legal advice as to how to respond to claims made under the Icebreaker policies. He alleged that the advice was that EIC had valid defences to the claims. However the judge held that the appellant had given false information about the scheme. It was not a reasonable inference from the facts that there had been any relevant collusion, nor any joint attempt by each and every member to engineer the failure of the LLP. If cl. 11.4 had the meaning for which counsel contended, the policyholder was never being protected against any risks whatsoever: the exclusion clause would bite immediately the policy came into effect and EIC agreed to underwrite the risks. The company would have designed a bespoke policy, framed to deal with these specific investments, which on its terms could never come into effect. It was a well established principle of insurance law that an exclusion clause in such a contract must be construed in a manner which was consistent with and not repugnant to the purpose of the insurance contract. To treat the very act of entering into the scheme as an act of collusion of a kind which fell within the scope of the exclusion clause would not be repugnant to the purpose of the policy and negate its purpose entirely. No court would adopt such a construction of the clause unless compelled to do so. It was submitted that the underlying tax avoidance scheme was immoral, at least in the sense of a social evil which the law should be unwilling to enforce. The courts and Parliament had adopted an increasingly hostile approach to what were perceived to be artificial tax avoidance schemes. It could not be said that all tax avoidance schemes should be outlawed. Even if the common law might be willing to expand the categories of contracts considered to be contrary to public policy, it should not do so in the context of allegedly abusive tax schemes. It was a highly complex and sensitive area. The common law doctrine of public policy could not invalidate either a contract's underlying tax avoidance arrangements or insurance policies underwriting the risk of loss arising out of such arrangements. For these reasons, the appellant's challenge to the finding of negligence with respect to the Icebreaker policies failed (paras. 168–230).

(5) The appeal against the judge's finding that the appellant breached the creditor duty on the grounds that he neither knew nor ought to have known that EIC was insolvent from June 30th, 2010 would be allowed. A director owed fiduciary duties to the company. In most circumstances, at least where a company was solvent, the duty was to advance the success of the company for the benefit of its shareholders, although that did not wholly exclude considerations of wider interests such as those of employees and suppliers. However, there were circumstances, insolvency being the classic example, where actions taken in the interests of the company must also involve consideration of the interests of the creditors (the "creditor duty"). The duty would arise where the company was insolvent (including imminent insolvency) and the directors knew or ought to have known that the company was actually or imminently insolvent. Once the creditor duty was engaged, the general body of creditors could not authorize or ratify breaches of duty which were no longer owed exclusively to them. Section 10(1) of the Insolvency Act 2011 provided that a company was insolvent if (i) it was unable to pay its debts as they fell due; or (ii) the value of its liabilities exceeded its assets (the "cash-flow" test and the "balance sheet" test). Given the nature of the insurance industry, the cash-flow test was not appropriate in this case. An insurance company could pay its debts as they fell due out of new premiums, but those premiums in turn attracted further potential liabilities which might arise beyond the reasonably near future. The position might be that there was no real possibility of the company ever being able to discharge those future liabilities, particularly if it was trading unsuccessfully, notwithstanding that it could, perhaps for a considerable period of time, pay its immediate debts as they fell due. In the application of the balance sheet test, it was not necessary to assess whether the company would be able to pay its debts when they fell due solely by reference to the information known to the directors at the material time. The court was entitled to use hindsight to determine whether the test was met. The judge was entitled to find that as a matter of fact EIC was

insolvent from June 30th, 2010 onwards. The evidence which he accepted, and the reasons he gave, fully justified that conclusion. However, the court rejected the judge's finding that, if the appellant did not know about EIC's true state of insolvency, he ought to have known. The appellant put substantial businesses of significant value into the Enterprise group in 2015 and the only reasonable inference was that he did not know that EIC was insolvent. The appellant was an experienced and successful businessman but he was not a qualified accountant. It was quite unrealistic to believe that he should have known that adjustments which EIC's expert thought should have been made to the accounts ought to have been included in the balance sheet. He could reasonably have assumed that these matters had properly been dealt with by the professionals. Nor could he be expected to have known that the accounts should have included, with respect to the motor business, the unexpired risk reserve entry to deal with the fact that the expenses and liabilities for the unexpired period of the policies were expected to exceed the value of the unearned premiums. These were in large part technical questions about the methodology of accounting, and in part disputes as to whether the figures had been properly determined. Although as a director the appellant was under a duty to satisfy himself that there was nothing obviously untoward about the accounts, it was not suggested that he deliberately deceived the auditors or had reason to believe that the audited accounts might be inadequate, at least with respect to the accounts adjustments. The real issue was whether the judge was entitled to find that the appellant ought to have known that, had appropriate reserves been calculated for potential liabilities arising out of the Icebreaker policies, the inability or failure to provide such reserves would have meant that EIC would have been insolvent for each year from June 30th, 2010 to 2016. The judge was entitled to conclude that the appellant (and no doubt the other directors) ought to have appreciated that some reserves were necessary; he could not hide behind his own negligence and claim that he did not realize that. However, it would not be fair to assume that the appellant ought to have appreciated that the defences would fail. The court also gave weight to the fact that neither the internal finance officers nor the auditors had raised any concerns about the potential insolvency of the company. The court appreciated that it was ultimately the duty of the directors to determine the appropriate reserves, but they would inevitably have to rely upon the advice and assessments of the professionals, the finance director and the external accountants. It was not enough to say, as the judge did, that there was evidence which objectively established the insolvency. It was necessary to have regard to all matters potentially bearing on what the directors ought reasonably to have appreciated. In that context it was highly material that none of the auditors for any of the years in question had concluded that the company was insolvent or even suggested that it might be, although they had expressed concerns about the adequacy of reserves in 2014 and 2015. It would not be justified to infer that because the appellant was negligent in failing to take steps to enable proper reserves to be set for Icebreaker, he should also have appreciated that a failure to do so would necessarily have meant that EIC was insolvent, simply as a result of that adjustment, from 2010 onwards. The court would not therefore find that the creditor duty arose. It followed that there was no breach of fiduciary duty on this ground when making the MSA or PIE payments, and ratification was not excluded on this ground. Nothing turned on this however, because the court had found that the requisite MSA and PIE payments were unlawful and were not capable of being ratified for other reasons (paras. 231–300).

(6) The court rejected the submissions that it had been unfair to continue the trial without the appellant being provided with legal representation. Nor did the judge make other material procedural errors in the course of the trial. The appellant had not sought a stay or an adjournment to seek funding for legal representation, and had in fact said that he was ready to proceed on his own. The basis of the challenge must therefore be that the judge should of his own motion have adjourned the case unless and until the appellant was able to obtain legal representation. In principle it was the duty of a judge to refuse to continue with a trial if he or she believed that a fair trial was not possible. This might in an appropriate case be because it was unfair to expect a litigant to defend himself. The right to a fair trial was a fundamental human right. Exceptionally, it would require that a litigant was represented, and there might be a duty on the state to secure representation. In this case, the appellant had had a degree of legal assistance. Detailed legal argument had been provided in counsel's skeleton arguments, witness statements had been prepared and counsel had opened the appellant's case. There was no doubt that the appellant was disadvantaged to some degree by the absence of a legal representative for the duration of the trial but such disadvantage of unrepresented litigants was a common feature of litigation and did not render the trial unfair. This was not a case where it was suggested that, if there were an adjournment, the appellant might find the funds necessary to obtain representation. A refusal to adjourn for that purpose might conceivably have been unfair, at least if there was cogent evidence that representation was a real possibility. However the appellant had been ready to proceed. He was a very capable, strong-minded and experienced businessman who had detailed knowledge of most of the issues raised at trial. In those circumstances, it was hardly surprising that the judge carried on. The judge had attempted to ameliorate the difficulties faced by the appellant, *e.g.* allowing the appellant to make notes whilst being cross-examined and to make re-examination part of his closing submissions, which gave him longer to prepare. This was far removed from the very exceptional case where lack of legal representation rendered the trial unfair. The appellant also complained about the way potential witnesses were dealt with by the court. Many of the original defendants had made witness statements but once their cases settled, they did not give evidence. However, the appellant could have called them and had a summons issued if they refused to appear voluntarily. It was not for the judge to call them. Nor would it have been open to the court simply to have accepted the assertions in their witness statements when they had not

been either sworn to or affirmed in the witness box, let alone tested by cross-examination; that would have been unfair to EIC. A key potential witness was Mr. Newing, who had been the finance director. However, the appellant made a considered decision not to call him, saying that the evidence supporting his case was already compelling and that Mr. Newing would not add anything further. The court could see no justified criticism of the judge's decision to draw adverse inferences from the failure to call Mr. Newing. Given that the decision not to call Mr. Newing was made by the appellant with knowledge of some of the potential implications, it did not sit well with three other problems he had identified about the lack of legal representation. The first was that he was disadvantaged when having to deal with accountancy and related insolvency questions. But he did have the benefit of assistance on these matters, albeit that the judge did not in the event find their evidence convincing. Moreover, a significant problem with relation to the accounts was that he could not challenge the factual basis of much of the evidence against him because of the lack of any evidence from Mr. Newing. That was a wholly predictable consequence of not calling Mr. Newing as a witness. The appellant also claimed he was disadvantaged as a litigant in person about which witnesses to call and on which issues, however he had been given clear indications that he should call Mr. Newing but chose not to do so (paras. 303–323).

Cases cited:

(1) *Acornwood LLP* v. *H.M. Revenue & Customs*, [2014] UK FTT 416 (TC); further proceedings, [2016] UKUT 361 (TCC); [2016] STC 2317; [2016] BTC 517, considered.
(2) *Airey* v. *Ireland*, [1979] ECHR 3; (1980), 2 E.H.R.R. 305, referred to.
(3) *Armagas Ltd.* v. *Mundogas S.A. ("The Ocean Frost")*, [1985] 3 W.L.R. 640; [1985] 3 All E.R. 795; [1985] 1 Lloyd's Rep. 1, referred to.
(4) *Armitage* v. *Nurse*, [1998] Ch. 241; [1997] 3 W.L.R. 1046; [1997] 2 All E.R. 705; [1997] Pens. L.R. 51; (1997), 74 P. & C.R. D13, considered.
(5) *Assicurazioni Gen. SpA* v. *Arab Ins. Group (BSC)*, [2002] EWCA Civ 1642; [2003] 1 W.L.R. 577; [2003] 1 All E.R. (Comm) 140; [2003] 2 C.L.C. 242; [2003] Lloyd's Rep. I.R. 131, referred to.
(6) *BNY Corporate Trustee Servs. Ltd.* v. *Eurosail-UK 2007-3BL plc*, [2013] UKSC 28; [2013] 1 W.L.R. 1408; [2013] 3 All E.R. 271; [2013] 1 BCLC 613; [2013] BCC 397; [2013] Bus. L.R. 715, considered.
(7) *BTI 2014 LLC* v. *Sequana SA*, [2022] UKSC 25; [2024] A.C. 211; [2022] 3 W.L.R. 709; [2023] 2 All E.R. 303; [2023] 1 BCLC 1; [2023] BCC 32; [2022] Bus. L.R. 920, referred to.
(8) *Barclays Mercantile Business Fin. Ltd.* v. *Mawson (H.M. Insp. of Taxes)*, [2004] UKHL 51; [2005] 1 A.C. 684; [2004] 3 W.L.R. 1383; [2005] 1 All E.R. 97; [2004] 76 TC 446; [2005] STC 1; [2004] BTC 414; 76 TC 446; [2004] STI 2435, considered.
(9) *Bucci* v. *Casa Estates (UK) Ltd.*, [2014] EWCA Civ 383, considered.

(10) *Central Bank of Ecuador* v. *Conticorp SA*, [2015] UKPC 11; [2016] 1 BCLC 26; [2015] Bus. L.R. D7, referred to.
(11) *Charterbridge Corp. Ltd.* v. *Lloyds Bank*, [1970] 1 Ch. 62, considered.
(12) *Ciban Management Corp.* v. *Citco (BVI) Ltd.*, [2020] UKPC 21; [2021] A.C. 122; [2020] 3 W.L.R. 705; [2021] 1 All E.R. 983; [2020] BCC 964; [2020] 2 BCLC 405, considered.
(13) *Clin* v. *Walter Lilly & Co. Ltd.*, [2021] EWCA Civ 136; [2021] 1 W.L.R. 2753; [2021] JPL 1210; [2021] BLR 259; 194 Con LR 26, considered.
(14) *Cosy Seal Insulation Ltd.*, *Re*, [2016] EWHC 1255 (Ch), referred to.
(15) *D'Jan of London Ltd.*, *Re*, [1994] 1 BCLC 561; [1993] BCC 646, considered.
(16) *Duomatic Ltd.*, *In re*, [1969] 2 Ch. 365; [1969] 2 W.L.R. 114; [1969] 1 All E.R. 161, considered.
(17) *EIC Servs. Ltd.* v. *Phipps*, [2003] EWHC 1507 (Ch); [2003] 1 W.L.R. 2360, considered.
(18) *FAGE UK Ltd.* v. *Chobani UK Ltd.*, [2014] EWCA Civ 5; [2014] CTLC 49; [2014] ETMR 26; [2014] FSR 29, considered.
(19) *Gwembe Valley Dev. Co. Ltd.* v. *Koshy (No. 3)*, [2003] EWCA Civ 1048; [2004] 1 BCLC 131; [2004] WTLR 97, considered.
(20) *Hellard* v. *Carvalho*, [2013] EWHC 2876 (Ch); [2014] BCC 337, considered.
(21) *Icebreaker 1 LLP* v. *H.M. Revenue & Customs*, [2010] UK FTT 6; further proceedings, [2010] UKUT 477 (TCC); [2011] STC 1078, [2011] BTC 1579, referred to.
(22) *Impact Funding Solutions Ltd.* v. *Barrington Support Servs. Ltd.*, [2016] UKSC 57; [2017] A.C. 73; [2016] 3 W.L.R. 1422; [2016] Bus. L.R. 1158; [2016] 6 Costs LO 903, referred to.
(23) *Inland Revenue Commrs.* v. *Duke of Westminster*, [1936] A.C. 1, considered.
(24) *Ivey* v. *Genting Casinos (UK) Ltd. (t/a Crockfords)*, [2017] UKSC 67; [2018] A.C. 391; [2017] 3 W.L.R. 1212; [2018] 2 All E.R. 406; [2018] Crim. L.R. 395; [2018] 1 Cr. App. R. 12, considered.
(25) *Ma Wai Fong* v. *Wong Kie Yik*, [2022] UKPC 14, referred to.
(26) *Madoff Securities Intl. Ltd.* v. *Raven*, [2011] EWHC 3102 (Comm); further proceedings, [2013] EWHC 3147 (Comm), considered.
(27) *Norglen Ltd.* v. *Reeds Rains Prudential Ltd.*, [1999] 2 A.C. 1; [1997] 3 W.L.R. 1177; [1998] 1 All E.R. 218; [1998] 1 BCLC 176; [1998] BCC 44, considered.
(28) *Otkritie Intl. Investment Management Ltd.* v. *Ivory Key Holdings Ltd.*, 2016 Gib LR 359, referred to.
(29) *Patel* v. *Mirza*, [2016] UKSC 42; [2017] A.C. 467; [2016] 3 W.L.R. 399; [2017] 1 All E.R. 191, referred to.
(30) *Pitt* v. *Holt*, [2013] UKSC 26; [2013] 2 A.C. 108; [2013] 2 W.L.R. 1200; [2013] 3 All E.R. 429; [2013] S.T.C. 1148; [2013] Pens. L.R. 195, considered.

(31) *Precision Dippings Ltd.* v. *Precision Dippings Marketing Ltd.*, [1986] Ch. 447, referred to.
(32) *R. (Kennedy)* v. *Financial Services Compensation Scheme Ltd.*, [2021] EWHC 3039 (Admin), considered.
(33) *Regentcrest plc (in liquidation)* v. *Cohen*, [2001] 2 BCLC 80, referred to.
(34) *Royal Bank of Scotland Intl. Ltd.* v. *Magner*, 2018 Gib LR 54, considered.
(35) *Royal Brunei Airlines Sdn. Bhd.* v. *Tan Kok Ming*, [1995] 2 A.C. 378; [1995] 3 All E.R. 97, referred to.
(36) *Runciman* v. *Walker Runciman plc*, [1993] BCC 223, referred to.
(37) *Salomon* v. *A. Salomon & Co. Ltd.*, [1897] A.C. 22; [1895–9] All E.R. Rep. 33; (1897), 66 L.J. Ch. 35, considered.
(38) *Seven Individuals* v. *H.M. Revenue & Customs*, [2017] UKUT 132 (TCC); [2017] STC 874; [2017] BTC 513, considered.
(39) *Singer* v. *Beckett*, [2007] 2 BCLC 287; [2001] All E.R. (D) 229, considered.
(40) *Smith & Fawcett Ltd.*, *In re*, [1942] Ch. 304; [1942] 1 All E.R. 542, considered.
(41) *Steel* v. *United Kingdom*, [2005] ECHR 103; [2005] 18 BHRC 545; [2005] EMLR 15; 41 E.H.R.R. 22, referred to.
(42) *Target Hldgs. Ltd.* v. *Redferns*, [1996] A.C. 421; [1995] 3 W.L.R. 352; [1995] 3 All E.R. 785; [1995] CLC 1052; [1995] N.P.C. 136; [1995] 3 LRC 162, referred to.
(43) *Three Rivers D.C.* v. *Bank of England (No. 3)*, [2001] UKHL 16; [2003] 2 A.C. 1; [2000] 2 W.L.R. 1220; [2000] 3 All E.R. 1; [2000] Lloyd's Rep. Bank. 235; [2000] 3 C.M.L.R. 205, considered.
(44) *Tiuta Intl. Ltd.* v. *De Villiers Surveyors Ltd.*, [2017] UKSC 77; [2017] 1 W.L.R. 4627; [2018] 2 All E.R. 203; [2018] 1 BCLC 179, considered.
(45) *Villeneuve* v. *Gaillard*, [2011] UKPC 1, considered.
(46) *W. & M. Roith Ltd.*, *Re*, [1967] 1 W.L.R. 432, considered.
(47) *W.T. Ramsay Ltd.* v. *Inland Rev. Commrs.*, [1982] A.C. 300, considered.
(48) *Watchorn* v. *Jupiter Indus. Ltd.*, [2014] EWHC 3003 (Ch); [2015] BPIR 184; [2015] 3 Costs LO 337, considered.
(49) *West Mercia Safetywear Ltd.* v. *Dodd*, [1988] BCLC 250, referred to.

Legislation construed:

Financial Services (Insurance Companies) Act 1987, s.58: The relevant terms of this section are set out at para. 9.

s.59: The relevant terms of this section are set out at para. 9.

Insolvency Act 2011, s.10(1): The relevant terms of this subsection are set out at para. 248.

Limitation Act 1960, s.26(1): The relevant terms of this subsection are set out at para. 153.

Income and Corporation Taxes Act 1988 (c.1), s.74ZA: The relevant terms of this section are set out at para. 220.

T. Poole, *K.C.* and *R. Pennington-Benton* for the appellant;
N. Jones, *K.C.* and *S. McCann* (instructed by Triay Lawyers) for the respondent.

1 **ELIAS, J.A.:**

Introduction

On July 25th, 2016 the respondent insurance company, Enterprise Insurance Co. plc ("EIC"), went into provisional liquidation and an order for its compulsory liquidation was made on October 26th, 2016 on the grounds that it was insolvent. In December 2016 the liquidator, Mr. White, asserted that EIC's deficiency was around £200m. That figure has been disputed, but on any view this was a very significant insurance failure.

2 EIC, acting by its liquidator, took proceedings against fourteen defendants. Eleven of them were, either for all or part of the period in issue, directors of EIC. Some were executive directors, and the rest were non-executive directors. A fourteenth defendant was Rhone Holdings Ltd. ("RHL"), which was for a period a 50% shareholder of Enterprise Holdings Ltd. ("EHL"), the holding company of EIC. EHL (in liquidation) and another of its subsidiaries, EIG Services Ltd. ("EIG"), also in liquidation, were the other two defendants, and proceedings were stayed against them.

3 EIC has settled the proceedings against all individual defendants, except Mr. Flowers. He was the major figure behind the Enterprise group. He was a director of all three Enterprise companies and was Chief Executive of EIC until 2014. It was alleged that in various ways he was in breach both of his fiduciary duties towards EIC and of the duty of care he owed to that company.

4 After a very lengthy and complex trial—there were over a hundred bundles of double-sided documents, and the factual and expert evidence together took some 31 days—Restano, J. found substantially in favour of EIC. In an impressive judgment running to some 360 pages, the judge set out in considerable detail the relevant principles of law, the evidence given by the witnesses of fact and experts, and his findings on that evidence. The assessment of damages was left to a later hearing.

5 The appellant challenges many of these findings. For the most part, the legal principles are not in any real doubt, although their application to the facts is very much in dispute. Furthermore, the appellant takes issue with some of the judge's findings of fact.

6 The appellant also alleges that the judge conducted the case unfairly. It was an unusual hearing in that the appellant dispensed with his counsel five days into the trial, he says for financial reasons. Mr. Flowers submits that thereafter it was unfair for him to have to conduct this complex case without proper legal representation. He also made other complaints about what he alleged were procedural failings by the judge, such as the way in which the judge dealt with the statements of witnesses who were not in the event called to give evidence. I deal with these procedural complaints at the end of this judgment.

7 Mr. Flowers has been represented in the appeal by Mr. Tom Poole, K.C. and Mr. Rowan Pennington-Benton. (The appellant's written argument had been prepared by Mr. Thomas Roe, K.C. and Mr. Pennington-Benton, but Mr. Roe was unable to appear at the oral hearing.) EIC was represented by Mr. Nigel Jones, K.C. and Ms. Sarah McCann, who had also represented it below. Counsel provided extensive written submissions, both before and after the hearing, and all four counsel have participated in the oral advocacy, each side distributing the burden of the submissions between their counsel. We are grateful to all counsel for their assistance.

EIC, the Commission and constraints on borrowing

The role of the Commission

8 The fact that EIC was an insurance company is an important feature of this case. It means that its income came from the premiums paid for insurance policies. By their very nature, all such policies involve insuring against a risk of a contingent or uncertain loss and, if and when the loss materializes, the liability crystallizes.

9 All licensed insurance companies with a head office in Gibraltar are subject to detailed regulations designed to ensure that they have sufficient capital to meet their potential liabilities. When introduced, they gave effect to solvency rules laid down in EU law. Because of the difficulty of predicting the extent of potential liabilities in a risk-based business, the rules are appropriately cautious. The basic principles at the relevant time were set out in the Financial Services (Insurance Companies) Act 1987. Section 58 dealt with reserves; it requires that the company shall at all times "maintain sufficient technical reserves to meet its underwriting liabilities." In practice this requires it to have sufficient capital to meet both its general business liabilities and its insurance liabilities. Section 59 is concerned with solvency margins and requires that the company "shall maintain a margin of solvency of such amount as may be prescribed or determined in accordance with regulations made for the purposes of this section." There are detailed rules relating to such matters as the calculation of assets and liabilities and the determination of solvency margins in the Insurance

Companies (Valuation of Assets and Liabilities) Regulations 1996 and the Insurance Companies (Solvency Margins and Guarantee Funds) Regulations 2004. The solvency margin is the excess of assets over liabilities. The effect of these rules is that the basic solvency requirement, known as the "required minimum margin," or RMM, sets a level of capitalization well above bare solvency. In part, this is achieved by the adoption of technical rules which forbid certain assets from being taken into account when assessing whether the RMM is satisfied, even though they could be brought into account when assessing basic solvency for non-insurance companies. Accordingly, even the basic RMM of 100% requires that an insurance company must hold more assets than an ordinary company would need to do in order to show balance sheet solvency.

10 A vital element in the protection of policy holders is that all insurance companies are subject to regular supervision and monitoring by the Gibraltar Financial Services Commission ("the Commission"). It has a particularly important role to play in ensuring that proper solvency margins are maintained and is given a wide range of powers by the 1987 Act to enable this to be done. Importantly, the Commission has power to impose a solvency margin above the required minimum as a condition of a company carrying on business, and it frequently uses that power. For example, when EIC moved into motor insurance in 2009, it was required to achieve a solvency margin of at least 120% RMM. Moreover, that was not just with respect to the motor business but in relation to all EIC's insurance activities. Similarly, in anticipation of the introduction of new EU solvency requirements from January 2016 (known as Solvency II), the RMM was increased to 150%.

11 There was a series of further measures conferred on the Commission by the 1987 Act, which the Commission could take in a variety of circumstances but in particular if the requisite RMM was not met or if there were for other reasons a concern about whether policy holders or future policy holders would be paid out. If there was a failure to maintain the technical reserves required by s.58, the Commission could by order prohibit the disposal by the insurer of any of its assets (s.62); and if there was a failure to maintain the margin of solvency required by s.59, the Commission could require the insurer to submit a recovery plan, to be agreed and then implemented by the insurer (s.62A). The Commission also had powers to limit premium income in the absence of further capitalization, thereby restricting the amount of business which could be transacted, either generally or in a specific area of business (s.66B); and the Commission could even prohibit the insurer taking on any new business (s.105). It also has very broad powers of intervention, such as the right to demand accounts or documents, as well as powers to issue written directions (s.100). As we shall see, it has had cause to exercise, or threaten to exercise, all these powers with respect to EIC at different times.

The "insurer borrowing constraint"

12 It is not possible for an insurance company to improve its RMM by taking out a loan. This was described by the director defendants in their statements of case as the "insurer borrowing constraint." The assets included in the calculation of the appropriate regulatory margin of solvency must be free and unencumbered, and a loan which gives rise to a future liability to repay is not unencumbered capital. Save in exceptional cases, any direct borrowing creates a matching future liability to repay and therefore it does not improve a company's solvency position. Indeed, it is likely to make it worse because any interest payable must also be reflected as a future liability. However, if a third party, such as an unregulated parent company, obtains the loan and puts unencumbered capital into the company, that does count as an asset for RMM purposes. The insurer will not be legally liable to repay the loan.

13 It is in part because of the effect of a loan on solvency margins that some insurance companies have established what the defendants described as a "triangular model" as a method of realising unencumbered capital. This model operates as follows. A holding company is established to own both the insurance company and a sister service company. The latter provides services to the insurance company, and the payment for those services generates profits which the service company can pay to the holding company as a dividend. The holding company can then use the dividend to inject capital into the insurance company, either directly or by securing loans from third parties to raise capital for that purpose. This was the corporate structure adopted by EIC when it became licensed by the Commission, adopting advice given by Fidecs Insurance Management Ltd., an experienced licensed insurance manager, which dealt with the licensing process on EIC's behalf. In the case of the EHL group, the service company was EIG. Other Gibraltar insurance companies had adopted a similar model although, unlike EIG, their service companies were registered in the UK whereas EIG was registered in Gibraltar. A fundamental issue in this appeal is whether EIG operated as a genuine service company and thus whether the payments made by EHL to EIC were made in accordance with a proper and lawful operation of the triangular model.

14 The solvency requirements were made stricter with effect from January 2016 in order to give effect to the tougher solvency regime imposed by the EU in Solvency II. The Commission sought to give effect to this by imposing an RMM requirement of 150%. This created considerable problems for a number of insurance companies in Gibraltar, including EIC.

15 The Commission could also impose other restrictions as a condition of granting the licence to carry out insurance business, and frequently did.

These were contained in the notice of requirements. Typically, and specifically in relation to EIC, it forbade the payment of dividends without its notification and consent. There would be no question of such consent being granted unless the Commission was satisfied that the company was securely capitalized. EIC never sought approval to pay a dividend to EHL, and there can be little doubt that it would have received a dusty answer had it done so, given that it had ongoing problems with maintaining the required capital limits.

The attitude of EIC towards the Commission and capitalization

16 A number of Commission officers gave evidence at the trial about the relationship between EIC and the Commission. The main witnesses were Mr. Oliver, who was until 2014 Head of Insurance Supervision in the Insurance Division of the Commission; his successor, Mr. Perdoni; Mr. Ritchie, who had been involved with the Commission in various positions for the whole period during which EIC was operating; and Mr. Garro, a regulatory officer answerable to Mr. Oliver and Mr. Ritchie. Mr. Garro and Mr. Ritchie were the officers most closely involved with EIC. The evidence of these officers was not central to any of the issues in the case, but it provides relevant background about Mr. Flowers' attitude to regulation and has some potential relevance to the issue as to his honesty.

17 The general picture which these officers paint is of a company which was generally uncooperative with the Commission and lacked transparency in the way it operated. There were ongoing concerns about a raft of matters which are recounted in detail in their evidence. Indeed, as early as 2010, EIC was placed on a "watch list," a list of insurance companies which the Commission perceived as posing the greatest risk to their meeting their regulatory requirements. EIC was never removed from that list.

18 The lack of adequate capitalization was perhaps the most significant and pervasive problem, together with related concerns about the adequacy of reserves entered into the accounts, and insolvency margins. But there were other concerns also. EIC had unrealistic business plans and often did more business than predicted, a cause of unease if it were under-capitalized, as it usually was. Its regular statutory returns were frequently delivered months late and were usually wrong, and therefore failed to give a true statement of the company's affairs. For example, in March 2013, EIC's figures indicated that it was meeting its enhanced solvency requirements but by August of that year the margin was only 101%.

19 The Commission took various steps to try to deal with these problems. Mr. Oliver dealt in his evidence with the period from 2010 until he left in 2014. He catalogues occasions when the Commission sought to impose premium limits on the business which EIC could transact because of the lack of capital, but they were either ignored or were not proceeded with

because EIC would produce capital at the very last moment. In 2010 the Commission exercised its statutory powers to issue a notice requiring the injection of further capital to restore financial probity. There were discussions about how this would be done, with the intention that a formal plan should be adopted, but proposed restoration plans were never approved, not even by the time of Mr. Oliver's departure in 2014. Concerns about the information provided by EIC led to the Commission requiring in 2013 what is termed a "skilled persons report," whereby an independent person reviews the systems and controls EIC had put in place to generate accurate management and financial information. (In fact, it later agreed to postpone this pending another report.) In 2013, the Commission also requested a technical actuarial report on its technical reserves as at March 31st that year, and said that it would require the reserves to be set at the best estimate levels fixed by the actuary—again, something which the directors consistently failed to do. At the same time, it informed the company that it required the RMM to be increased to 150% immediately, in anticipation of the introduction of Solvency II. However, following discussions it agreed to reduce this to 125% but required EIC to achieve 150% by the end of March 2014. In 2013 it had even drafted statutory notices to the effect that EIC should do no further business, but it did not send them once EHL had injected further capital into the business.

20 The evidence fully justified Mr. Oliver's observation to the judge that EIC "did not understand that the capital had to be in place first to underwrite the insurance, not injected into the company after the event."

21 In fact, an email from Mr. Newing, EIC's financial director, to Mr. Flowers in 2012 suggests that it was not a failure of understanding that this should be done: rather, it was a deliberate policy to operate in this way. The email related to a Commission communication rejecting EIC's latest financial restoration plan. Mr. Newing said this:

> "The letter isn't that bad. Certainly not as bad as it could have been. We have now been playing this game with them for nearly two years and premium growth has always been ahead of capital."

22 This shows that there was a deliberate policy to grow premium irrespective of whether the requisite capital was in place or not, and then to do just enough by further injection of capital to keep the Commission at bay. Mr. Flowers' reply shows the contempt in which he held the Commission:

> "[I]t is just the way they go about everything . . . and the way they just ran that meeting . . . they are spineless clueless people who know and understand nothing about the business they claim to regulate."

23 None of this directly establishes any breach of duty by Mr. Flowers towards EIC but it wholly undermines his contention that he was

transparent with the Commission about how EIC was operating, or that he co-operated with them. It also has some bearing upon his honesty.

The issues in the appeal

24 There are numerous issues in this appeal. I deal with them under four broad categories.

25 First, there is an issue about whether payments from EIC to EIG, ostensibly pursuant to an agreement whereby EIG was to provide marketing services to EIC ("the MSA"), were in fact payments made for no consideration, in breach of both Mr. Flowers' fiduciary duty to the company and/or his duty of skill and care. The judge held that Mr. Flowers was in breach of both. In so concluding, the judge had to consider a host of related issues concerning honesty, ratification, whether there was any loss, and the effect, if any, of periods of limitation.

26 There were other more minor transactions, some linked to the MSA, which the judge also held were improper payments unlawfully siphoned from EIC to the benefit of various parties, including in some cases to Mr. Flowers himself. I will deal with these matters after dealing with the MSA.

27 The second issue relates to policies issued by EIC underwriting the risks under a tax avoidance scheme known as Icebreaker 2. The judge found that Mr. Flowers had negligently failed to take advice about the risks involved in that scheme, although he acquitted Mr. Flowers of having acted in breach of fiduciary duty. As a result, the reserves entered into the accounts for these policies were wholly inadequate. Although there was an unearned premium reserve which, put broadly, caters for the possibility that part of the premium may have to be returned if the policy is cancelled before it is due to expire, there was no reserve at all to cover potential liabilities under these policies. In concluding that Mr. Flowers had been negligent, the judge rejected an argument that there were two defences to claims under the policies, one contractual and one public policy, which Mr. Flowers could reasonably have believed would have extinguished any liability and therefore justified the very small reserves which the directors had fixed referable only to returned premiums.

28 The third issue raises the question of whether EIC was in fact insolvent before it went into liquidation in 2016. The liquidator alleged that it was insolvent from June 30th, 2010. If that is so, and if Mr. Flowers knew or ought to have known that it was insolvent, then from that time he, as a director of the company, would have been under a duty to have regard to the interests of the creditors in the exercise of his duty to act in good faith in the interests of the company. It is alleged in the re-amended particulars of claim that Mr. Flowers was in breach of this duty in allowing EIC to make MSA and other payments to EIG from June 30th, 2010 onwards.

Moreover, once the duty to take account of the interests of creditors arises, any unlawful payment cannot be ratified by the shareholders.

29 The fourth issue raises various complaints about the way in which the judge dealt with procedural issues which arose in the course of the trial. Most fundamentally, it is alleged that he acted unfairly in allowing the trial to go ahead once Mr. Flowers had dismissed his counsel, some five days into the trial itself.

30 Virtually all the judge's conclusions have been challenged in this appeal. Many of the grounds of appeal are directed towards challenging conclusions of fact. As the authorities demonstrate, that is a difficult task.

The role of this court in reviewing facts

31 There has been much authority on the extent to which an appeal court can review the findings of fact of the judge, and the principles are not in issue before us. As Lewison, L.J. noted in *FAGE UK Ltd.* v. *Chobani UK Ltd.* (18), after citing numerous authorities from both the House of Lords and the Supreme Court of the United Kingdom ([2014] EWCA Civ 5, at para. 114):

> "Appellate courts have been repeatedly warned, by recent cases at the highest level, not to interfere with findings of fact by trial judges, unless compelled to do so."

He summarized a host of reasons which justify why this principle has been adopted.

32 To similar effect is the following passage from the more recent judgment of Carr, L.J. in *Clin* v. *Walter Lilly & Co. Ltd.* (13) ([2021] EWCA Civ 136, at paras. 85–86):

> "85. In essence the finding of fact must be plainly wrong if it is to be overturned. A simple distillation of the circumstances in which appellate interference may be justified, so far as material for present purposes, can be set out uncontroversially as follows:
>
> > i) Where the trial judge fundamentally misunderstood the issue or the evidence, plainly failed to take evidence in account, or arrived at a conclusion which the evidence could not on any view support;
> >
> > ii) Where the finding is infected by some identifiable error, such as a material error of law;
> >
> > iii) Where the finding lies outside the bounds within which reasonable disagreement is possible.
>
> 86. An evaluation of the facts is often a matter of degree upon which different judges can legitimately differ. Such cases may be closely

analogous to the exercise of a discretion and appellate courts should approach them in a similar way. The appeal court does not carry out a balancing task afresh but must ask whether the decision of the judge was wrong by reason of some identifiable flaw in the trial judge's treatment of the question to be decided, such as a gap in logic, a lack of consistency, or a failure to take account of some material factor, which undermines the cogency of the conclusion."

33 In Gibraltar, similar observations about the limited scope for reviewing findings of fact have been made by Sir Colin Rimer, J.A. in his judgments in both *Otkritie Intl. Investment Management Ltd.* v. *Ivory Key Holdings Ltd*. (28) and *Royal Bank of Scotland Intl. Ltd.* v. *Magner* (34). In the latter decision, he commented that in order to succeed on an appeal on fact (2018 Gib LR 54, at para. 109):

"It will not be enough to persuade the appellate court that, had it been the trial court, it might have arrived at a different factual conclusion from that favoured by the judge. The appellant has to show that the judge was wrong."

The MSA issue: the relevant law

34 I turn to the first main issue. The judge found that Mr. Flowers was dishonestly in breach of his fiduciary duty to EIC arising out of payments ostensibly made by EIC to EIG under the MSA. The following well-established legal principles are engaged.

The duties of a director

35 As a director of EIC, Mr. Flowers owed various fiduciary duties towards it and, quite independently of those duties, he had a common law duty to exercise skill and care in the performance of his functions. In the UK, the fiduciary duties have been codified in Chapter 2 of the English Companies Act 2006 but there is no statutory equivalent in Gibraltar. However, it is common ground that English cases concerning the nature and scope of the relevant fiduciary duties will be relevant to determining the common law position in Gibraltar, even those cases decided under the 2006 Act.

36 There are various aspects to a director's fiduciary duties, but the fundamental principle in issue in this appeal, and indeed the core duty underpinning the director's duty of loyalty to the company, is that the director must act bona fide in the interests of the company. This is a subjective duty. The classic statement of the principle is found in the judgment of Lord Greene, M.R. in *In re Smith & Fawcett Ltd.* (40) which concerned a discretion conferred on the directors whether to accept transfers of shares. Lord Greene held that in the exercise of that power the directors ([1942] Ch. at 306):

> "must exercise their discretion bona fide in what they consider—not what a court may consider—is in the interests of the company, and not for a collateral purpose."

37 Of course, if a court considers that no reasonable director acting bona fide in the interests of the company could have acted as the particular director did, that will be a powerful indication that he or she was not acting in good faith but it does not of itself prove that fact: see the observations of Jonathan Parker, L.J. in *Regentcrest plc (in liquidation)* v. *Cohen* (33). Ultimately the test is subjective, focusing on the director's state of mind—what he honestly believed. Accordingly, even if an intelligent and reasonable man could not honestly have believed that a particular transaction was in the interests of the company, if that was the genuine belief of the particular director, then he is not in breach of this fiduciary duty.

38 There is, however, an important qualification to this principle which arises where the directors have simply failed to address whether a course of action is in the best interests of the company at all. The subjective test cannot then be adopted since that presupposes that there will have been some consideration of the company's interests. But this does not mean that the directors who have failed properly to address the issue will necessarily be in breach of duty. In *Charterbridge Corp. Ltd.* v. *Lloyds Bank* (11), Pennycuick, J. imposed the following test in these circumstances, namely ([1970] Ch. at 74):

> "whether an intelligent and honest man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."

39 The latter is therefore an objective test. It asks whether the transaction in question could reasonably have been thought to be for the benefit of the company, even though the directors gave no thought to that question.

40 In *Charterbridge*, the context was that the directors of a subsidiary company had given security for a debt of its holding company. In so doing they had had regard to the interests of the group as a whole but without giving any consideration to the subsidiary's own interests. The judge emphasized that (*ibid.* 74):

> "Each company in the group is a separate legal personality and the directors of a particular company are not entitled to sacrifice the interests of the company."

That is not to say that the interests of the group are immaterial. The success of a subsidiary may benefit from a thriving group, and it may be consistent with the subsidiary's own interests for directors to take action which benefits another group company. But they cannot act in a way which is to the detriment of the company, however beneficial that may be to the group as a whole. The approach of the judge in *Charterbridge* has recently been approved by the Judicial Committee of the Privy Council in *Ma Wai Fong* v. *Wong Kie Yik* (25).

The meaning of dishonesty

41 The liquidator does not merely allege that Mr. Flowers was in breach of his fiduciary duty. He also submits that he acted dishonestly. If he was dishonest, this has potential legal implications in three areas which are in issue in this appeal. First, a dishonest act of the director cannot be ratified, and Mr. Flowers relies (in so far as he needs to) upon ratification in this case. Second, in certain circumstances the dishonesty can have the effect of extending the six-year period of limitation which otherwise applies when compensation is sought for breach of fiduciary duty. Third, if a director is dishonest, he cannot rely upon the statutory provision, s.477 of the Gibraltar Companies Act 2014 (or its predecessor in s.378 of the Companies Act 1930), which permits the court to excuse a director defendant's conduct if he has acted honestly and reasonably and ought fairly to be excused. (A finding of dishonesty may also have implications for a professional negligence insurance policy, but that is not in issue in this appeal.)

42 There is no general legal definition of dishonesty as such. Rather the law assumes that this is a concept which is sufficiently understood and so requires no specific definition. However, the law has had to determine whether, when assessing dishonesty, the factfinder (judge or jury) ought to apply a subjective test, asking whether the defendant believes that what he did was honest; or an objective test, asking whether a reasonable person in the position of the defendant would consider his conduct honest. After some vacillation, the courts have adopted the latter approach, although the objective test must be applied to the facts as understood by the defendant. It is, therefore, an objective test but applied to a subjective understanding of the facts. In *Ivey* v. *Genting Casinos (UK) Ltd. (t/a Crockfords Club)* (24), the Supreme Court brought the criminal law into line with the civil law with respect to this matter. Lord Hughes, with whose judgment Lord Neuberger, Lady Hale and Lords Kerr and Thomas agreed, summarized the position as follows ([2017] UKSC 67, at para. 74):

> "The test of dishonesty is as set out by Lord Nicholls in *Royal Brunei Airlines Sdn Bhd v Tan* and by Lord Hoffmann in *Barlow Clowes*: see para 62 above. When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question

> is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest."

43 There will be many breaches of fiduciary duty which will not be dishonest. Sometimes a breach will be innocent, such as where a director misunderstands the scope of his authority. He may even deliberately choose to act unlawfully, such as making an unauthorized investment, in the expectation that it will in fact be beneficial to the company. If he proves to be wrong, he is liable to the company for any loss arising from the risk he has taken, but he is not dishonest: see the example given by Lord Nicholls in *Royal Brunei Airlines Sdn. Bhd.* v. *Tan Kok Ming* (35) ([1995] 2 A.C. at 390).

44 However, there is very little scope for a finding that a breach of the subjective duty of good faith, involving the conclusion that the director did not genuinely believe that a transaction is in the interests of the company, can be said to be honest. Indeed, there is authority for the proposition that this will necessarily be dishonest. In *Gwembe Valley Dev. Co. Ltd.* v. *Koshy* (19), Mummery, L.J. referred to an earlier decision of Millett, L.J. to that effect ([2003] EWCA Civ 1048, at para. 131):

> "In Armitage v. Nurse [1998] Ch 241 at 251D, 260G Millett LJ held that, in this context, a breach of trust is fraudulent, if it is dishonest. He accepted counsel's formulation that dishonesty—
>
> > '. . . connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the company or being recklessly indifferent whether it is contrary to their interests or not.'
>
> and added:
>
> > 'It is the duty of a trustee to manage the trust property and deal with it in the interests of the beneficiaries. If he acts in a way which he does not honestly believe is in the interests of the beneficiaries then he is acting dishonestly.' (p 251D–F)"

Armitage v. *Nurse* (4) related to trustees rather than directors, but the same principle would apply to the latter.

45 By this definition of dishonesty, therefore, any director in breach of the subjective duty of good faith will be acting dishonestly since he does not honestly believe that he is acting in the interests of the company. The dishonesty does not arise because his conduct cannot be said to be bona fide in the interests of the company; it arises because he is knowingly acting

in bad faith and contrary to the interests of the company or is at least reckless as to whether it is in its interests or not. The only qualification I would make to this analysis is that one can envisage exceptional circumstances where the director genuinely believes that he or she is justified in not giving priority to the interests of the company. An extreme example would be somebody who wrongly uses company assets *in extremis* to obtain release from a kidnapper. Perhaps a little more realistically, a director of a company within a group of companies may genuinely believe that he is entitled to support a transaction which benefits the group, even if that is at the expense of the particular company. In that case a court, having regard to the director's subjective understanding of the law, would not be entitled to characterize the conduct as dishonest applying the *Ivey* test, even if it might be thought to demonstrate a surprising degree of ignorance by the director. Nor will a breach of the duty of good faith necessarily be dishonest in a case like *Charterbridge* (11) where there has simply been no consideration at all as to whether a particular transaction was in the company's interests. So in *Re W. & M. Roith Ltd.* (46), a director was held to have been in breach of the good faith duty when he arranged for his wife to enter into a service agreement in order to secure her a pension for life. The court found that no consideration had been given to the interests of the company. However, it does not follow that the director's breach of duty was dishonest even if the contract could not objectively be justified as in the interests of the company. A failure to have proper regard to the company's interests may be a breach of duty, but it cannot fairly be characterized as an act of bad faith amounting to dishonesty.

46 To find dishonesty, a court must be satisfied that an inference of dishonesty is more justified on the facts than an inference of innocence. As Lord Millett put it in *Three Rivers D.C.* v. *Bank of England (No. 3)* (43) ([2001] UKHL 16, at para. 186), "[t]here must be *some* fact which tilts the balance and justifies an inference of dishonesty . . ." Typically, an important consideration tilting the balance will be that a defendant has benefited from the conduct in question. Experience suggests that people are rarely deliberately dishonest unless they benefit, at least to some degree, from their dishonesty. If a director derives no obvious benefit from a particular transaction, therefore, an inference that the director genuinely made a poor—or even disastrous—business judgment, which he genuinely thought was in the company's best interests, is likely to be more justifiable than an inference that he acted dishonestly and in bad faith.

Summary of the MSA issues

47 At the heart of the appeal is the question of whether the appellant acted in good faith in the interests of EIC in the way it operated the triangular arrangement between EIC, its sister service company EIG, and their parent company EHL. Under the terms of the MSA, EIC paid EIG for providing

marketing services a fixed commission of 8% of its gross written premium ("GWP"). EIG then in fact transferred part of those sums received to EHL which in turn used part of that money to provide capital to EIC, generally in return for shares in EIC. However, neither company was under any obligation to EIC to take these steps, whether under the MSA or otherwise.

48 In this case, EIG derived its income exclusively from the payments it received from EIC. These were mainly fees ostensibly paid under the MSA but also payments made by EIC for use of what was termed the PIE technology information, which I discuss below. As the insurance business expanded—which it did significantly, particularly when it began to issue motor policies in 2009—so did the GWP and therefore so did the amount of the fee paid pursuant to the MSA. In total, over the twelve years from 2004 to 2016, EIC paid out some £50m. and received back from EHL some £33m. which took the form of payment for new shares. EIC also received rebates from EIG with respect to the PIE payments of around £12.4m. in total.

49 EIG did not pay over to EHL as dividends all that it received from EIC. It paid some £12.3m. to the then two shareholders of EHL, Mr. Flowers himself (operating through a trust fund) and RHL. These were ostensibly consultancy and directors' fees respectively. Nor did EHL pay all the dividends it did receive from EIG into EIC. EHL received some £16.6m. from EIG as dividends and it secured loans by taking out bonds worth some £44m. A major loan was raised when EHL issued bonds on the Frankfurt Stock Exchange which enabled it to inject some £21m. into EIC in 2013 when the Commission was seeking to increase the RMM percentage to 150%, in anticipation of the introduction of the Solvency II rules. Apart from the money invested in EIC, EHL used its assets for various purposes including to pay various consultancy and legal fees, interest and capital repayments on the loans, and to purchase an interest in a gastro pub called the Oxford Blue.

50 On the assumption that the MSA was properly implemented, and that the payment from EIC was a proper consideration for the services provided, EIC could have had no objection to what either EIG or EHL did with the money they received, notwithstanding that it was the ultimate source of their funds. EIC is not by such an arrangement subsidizing any capital later injected by the holding company back into the insurance company; it is paying a legitimate sum for a genuine service which of itself justifies the payment made, irrespective of whether any of the fees find their way back into the company as fresh capital. It might be seen as a bonus for EIC if they do.

51 However, the liquidator alleged that the MSA was not properly implemented; it was not carried out in the manner which its terms envisaged. He asserted that the MSA was a sham and that no services had

ever been provided by EIG under it. Mr. Flowers had dishonestly, and in breach of his fiduciary duty as a director of EIC, allowed money to be diverted from EIC in breach of the terms of its licence, partly to benefit himself. Furthermore, although some money had been used by EHL to capitalize EIC, this did not even match the sums paid out. The arrangement constituted a dishonest scheme which could not conceivably be said to be for EIC's benefit.

52 The judge, after a very full analysis of the extensive evidence on the point, upheld the claim. He found that, to the knowledge of Mr. Flowers, EIG had provided no services to EIC. In effect, therefore, it was simply giving money to EIG allegedly under the auspices of the MSA but in fact for no benefit whatsoever. In so far as there were capital injections into the business of EIC, this could not be controlled by EIC itself, and indeed a significant proportion of the fees paid was used for other purposes, including making a payment to Mr. Flowers himself in excess of £6m. This was ostensibly for consulting work, but the judge held that in reality it was a disguised dividend from EIG which could not have been paid had EIC complied with the regulatory safeguards imposed by the Commission. Furthermore, over the whole period of some twelve years, EIC did not even receive back from EHL the full amount of the money it had paid out to EIG.

53 In all the circumstances the judge held that the real purpose of the arrangement was to enable Mr. Flowers to decant money out of EIC in a way which could not possibly be said to be in its interests. It was also dishonest.

The concept of disguised dividends

54 A reference to "disguised dividends" occurs in the judgment and some of the emails. If the 8% fees paid from EIC to EIG were genuine, these would be proper expenses and the notion of disguised dividends would be inappropriate. But if they are gratuitous payments, the only way in which they could lawfully be made is if they could be paid by way of dividends. This would require them to be paid to shareholders out of distributable profits and with the approval of the Commission. EIC could not pay dividends to EIG since it is not its shareholder. It could in principle pay dividends to EHL, and the money it paid EIG was intended, at least substantially, to be paid to EHL. In fact this was achieved by EIG paying a dividend (and so described) to EHL. Mr. Flowers, as a shareholder (through his family trust) of EHL could receive dividends from that company. In effect, therefore, EIC was the source of what were in substance, but not in form, dividend payments to EHL; and gratuitous payments to Mr. Flowers from EIG, sourced by EIC, were in substance payments which he could only have legitimately been paid as dividends by EHL.

The judgment below

55 Mr. Flowers appeals against this decision on various grounds. Before setting them out, it is necessary to summarize the evidential basis for the judge's conclusions, and his reasoning. He set out the evidence relating to this part of the case chronologically by focusing on three periods: what occurred during the licensing process when the terms of the MSA were settled; events during the initial trading period from 2004 to 2009; and events from 2009 when EIC expanded into the motor insurance market until the company went into liquidation in 2016. The interwoven issues he was deciding with respect to this part of the case were whether EIG was actually performing any services for EIC; whether Mr. Flowers was acting bona fide in the best interests of the company; and whether he was dishonest. There is a considerable degree of overlap with respect to the evidence relating to those three matters. Indeed, as set out above, there is an inextricable link between the alleged breach of the duty of good faith and dishonesty.

Were services provided to EIC?

56 Mr. Flowers' primary case was that EIG was performing services under the MSA and that the judge was wrong to find otherwise. Virtually all the staff were employed by EIG and the natural and obvious inference was that they were working for EIG. Mr. Flowers asserted that there had been a variation of the original signed agreement, and it could not be said that only marketing services were carried out. He alleged that there had been oral agreements over time expanding the range of services provided. He agreed that nobody had told the Commission of this, nor had the variation been agreed in writing, as the MSA itself required. But for the same fee as had originally been negotiated, EIG was performing a wide range of insurance functions. He also accepted that these would include some functions which could not lawfully be performed by an unlicensed body.

57 The judge gave a detailed analysis of the reasons for his conclusion that there were no services provided, whether under the original MSA agreement or an informally expanded version of it. I would summarize the main factors as follows.

58 First, in the course of extensive licensing negotiations with the Commission prior to EIC commencing trading, the services to be provided by EIG were limited to marketing services only, and these were carefully and precisely defined. The judge noted that considerable care had been taken to ensure that EIG would not be carrying out any services which would require it to be licensed by the Commission. In order to ensure that this would not be so, there had been a substantial modification of the agreement as initially proposed involving a significant reduction in the

range of services to be provided by EIG. There had been a corresponding reduction in the fee from some 17% to 8%. The unchallenged evidence was that the extended services allegedly being carried out included licensable activities. It was hardly likely that EIG would now happily embrace these additional functions for which a licence would be required. Furthermore, no application for a licence was ever made.

59 Second, for the first two years of its existence, EIG employed no staff. They were all employed and paid by EIC, including Mr. Flowers. The situation changed on June 30th, 2006 when virtually all the EIC employees—but not Mr. Flowers—were transferred to EIG. The evidence demonstrated that the reason for transferring the staff was that the Commission had expressed concerns that EIC was carrying out some activities involving work for a subsidiary of its predecessor company, IOMA, which the Commission thought was in breach of relevant legislation. To remedy this, the work was given to EIG to carry out, and employees were transferred to EIG to undertake those tasks. It was not clear why virtually all the staff were transferred in this way rather than simply those engaged in the work transferred, but that is what was done. There is no contemporaneous evidence of any kind to suggest that the purpose was to transfer any of EIC's licensed functions to be performed by EIG, and every reason for regarding the evidence as suggesting otherwise, not least because EIG would not want to provide such services because it did not want to obtain the requisite licence.

60 Third, contemporaneous documentary evidence was wholly inconsistent with EIG being the company actually performing the relevant functions, as opposed to providing the staff to enable EIC to carry them out. This included a structure chart sent by Mr. Newing, the finance director, to the Commission in 2014 representing that EIC had thirty staff in 2013 and forty in 2014. These were staff formally contracted to EIG but in reality working for EIC. Other internally generated documents were to the same effect.

61 Fourth, EIC met all the staff costs, in addition to the 8% fee for services, until the year ending March 2013 when EIG became responsible for these payments (although the payments were in fact backdated to 2011). It was only then that EIG undertook this basic obligation of an employer to pay its employees, apparently following concerns expressed about the arrangement by the Commission. This paying arrangement until 2013 was entirely consistent with the notion that employment with EIG was simply a matter of form, not substance. Even after 2013, nothing changed with regard to how the work was actually performed.

62 Fifth, EIG had no premises and no overheads. This was hardly consistent with it carrying on an independent marketing business at arm's length from EIC.

63 Sixth, there were contemporary emails between Mr. Newing and the Commission in which the Commission sought to discover precisely what work EIG was doing. Mr. Newing claimed that it was marketing and administrative work, although in fact the latter had been specifically excluded in the course of the original negotiations with the Commission. Moreover, he gave no examples of, or documents relating to, the work which EIG had ostensibly done. In 2015, specifically in response to a request from the Commission asking whether there had been any changes in the MSA agreement, he said that there had not. He did not seek to justify the fees paid to EIG by claiming, as Mr. Flowers had done, that there had been an informal amendment to the MSA as a result of an increase in the range of services performed by EIG over time. Mr. Flowers and Mr. Newing were both directors of EIG and yet they could not apparently agree about what work it was undertaking.

64 Seventh, the judge identified various ways in which Mr. Flowers and Mr. Newing had sought to conceal from the Commission evidence which might lead them to scrutinize what services were being provided for the regular annual fee. These included being unwilling to provide a copy of the MSA to the Commission, even after it had been requested; Mr. Flowers emailed Mr. Newing saying that he did not think they should reveal it. The judge commented that in this and other ways, the attempts by Mr. Garro of the Commission to obtain information about the operation of the MSA were stymied. This suggests that they knew that the arrangement was not legitimate and would attract the opprobrium of the Commission, and possibly the imposition of sanctions.

65 Eighth, there are a number of emails, discussed below, which show that both Mr. Flowers and Mr. Newing thought that no services were provided. They include a statement from Mr. Flowers himself that "theoretically" EIG provided services. If the principal actors understood this to the case, it is very powerful evidence that it was in fact the case.

Breach of fiduciary duty and dishonesty

66 The *Smith & Fawcett* test required the judge to determine whether Mr. Flowers genuinely considered the payments to be in the interests of EIC in the light of the facts as he understood them to be. A critical feature of that analysis was whether Mr. Flowers appreciated, as the judge found, that EIG was not providing services for the payments received from EIC. Mr. Flowers claimed (as did Mr. Cruz and Mr. Stone in their evidence) that he understood that EIG was performing services, albeit extended in scope from the marketing services which the MSA originally envisaged. If this was indeed Mr. Flowers' genuine subjective perception of the situation, it would be the basis on which the good faith test would have to be assessed (and, indeed, the *Ivey* honesty test). It would mean that EIC would have allowed a non-regulated body to perform its insurance functions in breach

of the regulatory requirements, and it might well have been a breach of fiduciary duty for the directors, including Mr. Flowers, to permit that to happen. But it would be a very different case from the one which Mr. Flowers now faces.

67 The basis for asserting a genuine, if mistaken, belief that EIG may have been performing services for EIC was that since EIG was the formal employer of virtually all the staff, the work they were doing must have been actually done for EIG: typically, employees do the work for their own employers rather than being made available to work for other companies. This might have been a reasonable inference absent any knowledge of how the arrangements were actually working out in practice. However, the judge referred to numerous emails, two of which are considered below, which unambiguously showed that both Mr. Flowers and Mr. Newing knew that essentially EIG was doing nothing for its fee.

68 There was no dispute about how the money had been used once transferred to EIG. As indicated above, some had been transferred from EIG to EHL; some had been paid out to EHL's two shareholders, including Mr. Flowers' own family trust, ostensibly as consultancy or directors' fees but in reality as dividends; and some had been returned to EIC. However, the judge noted that the sums returned by way of capital injections and rebates were less than it had paid out. The judge found that even applying the subjective test, Mr. Flowers did not act in good faith; he did not honestly believe that the payments made to EIG by EIC were in EIC's best interests. The judge accepted that initially the parties may have genuinely intended to outsource and ring-fence the marketing function, as the MSA envisaged, but it soon became clear that this was not how the arrangement was going to operate.

69 In reaching the conclusion that Mr. Flowers acted in breach of duty, the judge drew attention to two emails which he described as "particularly striking" (at para. 700). The first, dated March 23rd, 2011, was from Mr. Newing, copied to Mr. Flowers, which explained the role of EIG as follows:

> "As you know, we decant much of the revenue from the insurance business into EIG Services which is our unregulated owner of our underwriting system. Staff are employed by Services which effectively is the pseudo insurance manager and back office for Enterprise. That said, Enterprise carries the cost of payroll in its books. We therefore try to pass as much revenue from Enterprise to Services such that the former effectively breaks even. The methodology for that is that it is much easier for the shareholders to take profit from the unregulated entity than the regulated one.
>
> EIG Services has a very small cost base since the staff costs are picked up by Enterprise. The only real expenditure is system related and

incidentals such as audit fees etc. The biggest expense caption is 'Consulting' by which I mean the payments to Rhone and the Flowers Family Trust . . .

As you will see from the attached profit and loss, we calculate Services as the net of the 8% of Enterprise GWP we are allowed to pass over, the fee Services charges Enterprise for the rental of the system and the minimal cost base. This profit clearly is after 'consulting' as at the bottom of the analysis I have added back this cost to derive the true added value to the Shareholders . . ."

70 The judge did not spell out why he considered this significant, but it is self-evident. This email identifies four important features of the arrangements. First, the reference to EIG being the "pseudo insurance manager," although somewhat cryptic, suggests that it was not doing what it appeared to be doing. Second, it shows that the intention was always to keep EIC at break-even point and thereby enable EIC to transfer as much money to EIG as possible, irrespective of whether this was in EIC's interests or not. (This is also consistent with, and explains why, premiums were always chasing capital.) A third and inter-related object of the arrangement was to ensure that EIG should bear as little of the cost as possible, thereby maximizing the sums available to it for redistribution outside the purview of the Commission. Fourth, an important reason for setting up this arrangement was to facilitate the shareholders (*i.e.* Rhone and the Flowers Family Trust) taking profit from an unregulated company, which avoided the need for Commission approval.

71 The second email, dated September 23rd, 2013, was from Mr. Flowers to a third party in which he referred to the fact that EIG "theoretically" provided services which in reality were at "little or no cost." He plainly recognized that no services were provided; the arrangement was a sham.

72 The judge summarized the significance of these two emails as follows (2023/GSC/008, at para. 700):

"These contemporaneous communications provide a very valuable insight into Mr. Flowers' state of mind concerning these payments at the time which is of crucial importance. The fact that Mr. Flowers did not want to draw attention to these arrangements with the [Commission] showed that he was fully aware that they were improper, which should in any event have been clear to an experienced businessman such as him."

73 Finally, the judge summarized the nature and purpose of the transactions as follows (*ibid*., at para. 696):

"The proper conclusion to be drawn from all the evidence is that the MSA was not an agreement governing the provision of legitimate services by a service company to an insurance company, and which generated legitimate profits. The MSA was a fig leaf which, especially after 2010, allowed funds to be stripped out of EIC as if they were legitimate commercial expenses when they were not, and which were not in the best interests of EIC to make. The fact that large amounts of money, around £35.35 million, flowed back into EIC only illustrates the sham nature of the arrangements, and that EIC was using the MSA as a conduit to pay substantial amounts of money out of EIC. The payments which were paid back into EIC were a means of propping EIC up which allowed it to keep writing further premium, for greater losses to be incurred, whilst allowing for ongoing substantial payments to be made out to Mr. Flowers and others along way."

74 Following Millett, L.J.'s analysis in *Armitage* (4) (at para. 44 above), the judge's conclusion that Mr. Flowers had deliberately failed to act in the best interests of EIC constituted dishonesty. Mr. Flowers did not allege that he believed that he was entitled to advance the interests of the group at the expense of the subsidiary, which would have affected the analysis of dishonesty (see para. 45 above); he was always contending that he had at all times acted in the best interests of EIC.

75 The judge added, for good measure (*ibid.*, at para. 704) that:

"Even if I am wrong about Mr. Flowers' subjective intention and he felt justified in doing what he did, I would still conclude that his conduct was dishonest when viewed objectively as an ordinary decent person would regard what he did as dishonest."

76 With respect to the judge, this is not an alternative route to finding liability for breach of fiduciary duty, as the judge impliedly suggests. On the premise that the judge was wrong, it would mean that on a proper application of *Smith & Fawcett* (40), he would have found (however implausibly) that there was no breach of fiduciary duty because Mr. Flowers genuinely believed that the payments were in the best interests of the company. No doubt in those circumstances the judge would also have found that Mr. Flowers did not believe his actions to be dishonest; if Mr. Flowers appreciated that his conduct was dishonest, it is difficult to see how his actions could possibly be thought to be in the interests of the company. But once the judge had found that Mr. Flowers honestly believed that he was acting in the best interests of the company, there would be no breach of fiduciary duty and the fact that Mr. Flowers was nonetheless objectively dishonest, applying the *Ivey* test, could not alter that conclusion. It would involve a rewriting of the *Smith & Fawcett* test were it to do so.

The grounds of appeal

77 Mr. Poole, K.C., counsel for Mr. Flowers, mounted a root and branch attack on the judge's analysis. I summarize his argument under four heads.

These may be summarized as: services were provided; in any event, the creation of the capital facility itself justified the payments; there was no loss; and the Commission were always aware of how the arrangement operated.

78 First, he essentially reiterated the argument that Mr. Flowers had advanced below, that the judge's conclusion that there were no services for the annual 8% fee was not supported by the evidence. On the contrary, the staff were legally employed by EIG, and this meant that they must be treated as its staff. The services they were carrying out for the benefit of EIC were nevertheless services performed for EIG in their capacity as EIG's employees. Mr. Poole accepted that this would mean these staff would be performing licensed work and EIG did not have the relevant licence but he submitted that that was a matter for the regulatory agency. It did not undermine the fact that EIG was carrying on a wide range of functions for EIC which amply justified its fee. He also accepted that there was no variation of the MSA in writing, as the agreement required. Again, he submitted that this was irrelevant because the parties could mutually dispense with that requirement, and their conduct had shown that they had intended to do so. This was in fact a perfectly proper triangular arrangement of a kind adopted by many insurance companies to facilitate the introduction of capital by unregulated companies.

79 Second, he argued that in determining whether there was a breach of the duty of good faith, the judge had simply failed to recognize the true significance of the arrangement. He had not given any weight to the fact that it was always the principal objective of the arrangement that a substantial part at least of the moneys paid out by EIC should be returned in the form of capital. This was vital in order to enable it to develop its business. Mr. Poole made what can only be described as the strikingly bold submission that even if he were wrong on his first submission, and the judge was entitled to find that there were no services provided for the 8% fee, this was ultimately immaterial. The real purpose of the MSA arrangement had always been to facilitate the introduction of capital into EIC and circumvent the borrowing constraints on insurance companies, and this had been achieved. Furthermore, even if the operation did not have the sanction of the regulator or involved a breach of any obligations imposed by the regulator, that was also irrelevant. Mr. Flowers owed no fiduciary obligation to the Commission. The only question was whether there had been a breach of the fiduciary duty he owed to EIC itself; duties owed to the Commission were not in point.

80 A third and closely related point was the submission that if the figures are properly analysed, the capital returned to EIC in the form both of reimbursements from EIG with respect to the PIE payments and regular capital injections by EHL virtually matched the sums paid to EIG (and possibly, it was suggested, might even have exceeded it). There was little,

if any, shortfall. It is said that whilst the judge had had regard to these repayments in the context of calculating loss (albeit erroneously) he did not appreciate their relevance in determining whether there was a breach of fiduciary duty in the first place or, indeed, when considering the question of dishonesty. The fact that others, including Mr. Flowers himself, had also benefited from these arrangements did not render them unlawful or improper. The only question was whether the application of the triangular model benefited EIC; and the directors, including Mr. Flowers, were fully entitled to take the view that they did.

81 Fourth, Mr. Poole submitted, as had Mr. Flowers below, that contrary to the finding of the judge, the Commission had been fully aware how the arrangement was working and had raised no objection to it.

Discussion

Were services provided?

82 In my view, for the extensive reasons given by the judge and dealt with in far greater detail than my summary has provided, he was fully entitled to conclude that EIG provided no services pursuant to the MSA. The staff were only formally employed by EIG; as a matter of substance, in reality they worked for EIC. There was ample evidence to justify that conclusion, including the contemporaneous emails and other documents which demonstrated that Mr. Flowers and Mr. Newing themselves believed this to be the case. There was simply no evidence of any marketing work which might justify the fee claimed, and no evidence of any other services provided. I agree, as Mr. Poole submitted, that the fact that EIC was not open with the Commission about the arrangement, or that there was no formal variation of the MSA in the form which the agreement itself required, would not of themselves necessarily justify the inference that the contract had not been varied. But they are not without evidential significance, and in any event, there were far more significant factors justifying the judge's conclusion, not least the contemporaneous documentary evidence that Mr. Flowers and Mr. Newing did not themselves believe that EIG was providing services to EIC pursuant to the contract.

83 This is not to say that EIG did nothing at all for EIC. Mr. Poole emphasized the fact that it did make its staff available and at least from 2013 (and backdated to 2011) it paid for them itself. This does not, however, materially help his case. The provision of staff might conceivably have justified some sort of fee over and above the actual salaries involved, but only if EIG, as opposed to EIC, could be said to be actively administering the staff's contracts and related employment rights, which seems doubtful if the purpose was to keep their costs to a minimum. In any event, these were not services pursuant to the agreement and they were not the services relied upon to justify the payments. Moreover, it is difficult to

see how there could be any justification for paying a fixed 8% of the GWP for any such service; that would be a gross overpayment. One would expect the fee to be related in some way to the number of staff rather than the turnover of business.

84 It is also pertinent to note that the judge considered in terms the possibility that the reality might be that EIG was indeed doing the expanded range of duties, and that "EIC's obfuscation was because it was concerned about licensing issues" (2023/GSC008, at para. 652). However, he rejected this in the light of "ample and compelling contemporaneous evidence" to the contrary. In my opinion there is no proper basis on which this court could properly interfere with that conclusion.

The capital facility submission

85 Mr. Jones submitted that in asserting that the purpose of the MSA was to facilitate the injection of further capital, Mr. Poole had made a pivotal change of tack; this was not an argument which had ever been pleaded, and nor had it been advanced below. The only issue then was whether the MSA, either in its original form or as informally amended, was a genuine agreement with services provided in accordance with its terms. To the limited extent that there was any reliance on the wider financing purpose, it was only as a supplementary advantage lending support to the principal argument. Accordingly, the appellant should not be permitted to run this argument now.

86 I see considerable force in that submission. There is undoubtedly a very substantial shift in the way in which the argument is now advanced. What was an incidental feature of the arrangement now takes centre stage. The judge never analysed the case on this basis but that can hardly be described as an error of law when it was not the argument addressed to him. The criticism which Mr. Poole directed at the judge on this score was wholly misplaced.

87 It is not as if the judge entirely ignored the fact that some money was returned to EIC. It was always part of the factual background and indeed was central to the contention (which the judge rejected) that EIC had provided financial assistance to enable EHL to buy its shares. Moreover, the judge made certain observations about the way in which the MSA model itself worked in a section of his judgment headed "The recirculation of money" (*ibid.*, at paras. 656–667). Those paragraphs were primarily focused on whether the Commission knew of the arrangement. (Mr. Flowers had strongly contended that it did, but the judge held otherwise.) However, the judge also observed in passing (*ibid.*, at para. 667) that "any such arrangement also rides roughshod over basic principles of company law and is bedevilled with problems." He identified, as one of the problems, the fact that once the money had gratuitously been paid to EIG,

there was nothing to bind the directors of either EIG or EHL to give effect to any arrangement for it to be reinvested into EIC by EHL.

88 Nevertheless, given that there are serious findings of dishonesty against Mr. Flowers, I would in principle allow him to pursue this new argument. An important consideration is that counsel did not suggest that any further evidence needed to be adduced to enable the submission to be fairly considered.

89 At the heart of this newly framed argument is the contention that setting up a triangular model to facilitate capital investment back into EIC benefits EIC irrespective of whether any services are provided by EIG or not. Mr. Poole submitted that the judge should simply have asked whether this was a triangular model and what were its essential features. He asserted that it plainly was, and that its essence was manifestly in EIC's interests: it allowed for the extraction of money from EIC in the context of an arrangement designed to enable capital to be injected back into the company as and when needed.

90 I would reject that submission. There is no magic in the concept of the triangular model. It is not a term of art which somehow permits EIC gratuitously to give money to EIG in the hope that it might end up back in its own coffers. This arrangement is far removed from a legitimate agreement where services are provided for the fees paid. That is a proper arrangement whereby full value is gained for the consideration given. The profits generated by the service company might, in whole or in part, make their way back to the insurance company as fresh capital. By contrast, this argument claims that it is immaterial what the ostensible justification is for EIC transferring money to EIG: the fact that money is intended to be circulated is its own justification. This treats the provision of services as of no significance, an entirely peripheral feature of the model which can be dispensed with. That cannot be right. If it were, it is difficult to see what function the service company provides. One might as well by-pass the service company and pay the money directly to the holding company to be put back as fresh capital. That would plainly be unlawful unless the money was paid to the holding company by way of dividend, and that could only be done with the relevant Commission consent and from distributable profits.

91 So even if the principal purpose were to provide capital finance, one would still have to ask whether Mr. Flowers could genuinely believe that the payments to EIG, made for no consideration (except the provision of staff) and in breach of regulatory requirements, was in the best interests of EIC.

92 In this context, and contrary to the submissions of Mr. Poole, I consider that it is highly relevant that the arrangement was carried out in breach of EIC's obligations to the Commission. It was deceived in two

ways in particular. First, it was unaware that EIC was in substance paying a dividend to EHL, which would never have had the approval of the Commission. Second, it misrepresented the true nature of the capital being paid by EHL into EIC. It had the appearance of being unencumbered capital but in fact EIC was covertly paying for this capital. It is true that EIC would not be legally liable to meet any failure by EHL to meet the loan repayments, nor was it legally obliged to pay the interest on the loans. But the reality was that if EHL defaulted on the loan, that would put the whole Enterprise group in jeopardy. The repayments could only be made for so long as EIC continued to provide the payments to EHL via EIG. In substance, EIC was committed to continue paying for the loan in order to stay afloat. Such an arrangement could never have passed muster with the Commission had it appreciated what its true nature was.

93 I would also reject Mr. Poole's submission that the relationship with the Commission is irrelevant to the duty owed to EIC, as though EIC were unaffected by the deception. That is simply not the case. It was at real risk of having its business subject to all sorts of sanctions, including being shut down, if it had been discovered that the regulatory rules were being flouted in such a flagrant way. It cannot be in the best interests of EIC to be put in that position of insecurity. As Mr. Jones aptly observed, it may be financially beneficial to a company not to pay its taxes, but it is difficult to envisage a director successfully being able to contend that he genuinely believed that it was in the best interests of the company for its directors to engage in tax evasion on its behalf in the hope that it will not be discovered and the company will benefit. At least, an experienced businessman like Mr. Flowers could not seriously advance such a submission with any prospect of success.

94 Quite apart from these considerations, the premise of this rejigged formulation is unsustainable. The submission—or more accurately, the assertion—that the principal purpose was to facilitate the growth of capital to enable the company to develop is at odds with the facts found by the judge on evidence he was entitled to accept. It is simply not an inference which could properly be drawn from the evidence. The judge's justified finding was that the aim was to siphon money from EIC in order to enable it to be used for a variety of purposes, some of which were wholly unrelated to any conceivable benefit to EIC. These included enabling both EHL and its shareholders, which included Mr. Flowers, to receive payments which the judge found were akin to dividends, thereby circumventing the regulatory controls imposed by the Commission. Moreover, the contention that the purpose was to secure capital that would not otherwise be available because of the borrowing constraints on insurance companies is again inconsistent with the evidence. The company paid out more capital than it received back, if only marginally. Moreover, the deliberate strategy of keeping the company at a "break-even" basis meant that it was always

intended to control its access to capital, not to maximize it. EIC was simply giving money to another *unregulated* company which could deal with it as it saw fit without regulatory constraints. The fact that some capital was re-introduced into EIC as and when required is a far cry from the principal purpose of the arrangement being to facilitate its capital position.

The submission of no loss

95 As to the argument that there was no loss, that is irrelevant to the question of whether there is any breach of fiduciary duty. I accept that it is critical in establishing liability in the common law tort of negligence, which the judge also found, because damage is the essence of the action. But that is not so for breach of fiduciary duty. The fact that capital is paid back into the company may be material to the question of whether the defendant acted genuinely in good faith and therefore to the related question of dishonesty, but in my view it clearly is not sufficient in this case to absolve Mr. Flowers of the finding that he was in breach of his fiduciary duty with respect to the operation of the MSA.

96 In any event, the assumption that there has been no loss is far too simplistic, even if it can be shown that the sums paid back into EIC were equal to, or possibly even greater than, the sums paid out. The question is what loss flows from the breach, and this requires consideration of what EIC would have done had it retained the money instead of paying it away. It might, for example, have earned interest on it, which would have increased the loss. That is for the judge to determine (although in the light of our ruling on whether the capital put back into EIC can properly be set off against the losses, which is discussed below).

The knowledge of the Commission and its relevance

97 The question of whether the officers at the Commission knew how the MSA was operating was examined at some length by the judge. Mr. Flowers had placed no little weight on the assertion that they did, and that this was material to whether he was acting in breach of duty. The judge accepted the evidence of the Commission witnesses that they did not appreciate that the source of the capital put back into EIC was EIC itself, nor did they realise that no services were being provided by EIG. Mr. Poole took issue with those findings. In my view there is no basis for upsetting those findings of fact, although I recognize the force of Mr. Poole's observation that the Commission ought to have appreciated that EIC had to be the ultimate source of EHL's money. However, even had they appreciated that, it is not in the least surprising that they did not know that EIG was not performing services for the fees received, particularly given that Mr. Newing and Mr. Flowers did their best to prevent them from finding out. This essential feature of the arrangement was unknown to them.

98 Even were the judge to be wrong about that, it matters not. Whether the Commission knew precisely what the arrangement was or not, the Commission could not relieve Mr. Flowers of his fiduciary obligations. At best, its stance may in principle have some relevance to the question of dishonesty but, even then, only if it could be shown that reliance had been placed by Mr. Flowers on what appeared to be an acceptance by the Commission that the arrangement in question was permitted. That is plainly not this case.

Conclusion on breach of fiduciary duty

99 I see no basis on which it would be proper to interfere with the finding of the judge that Mr. Flowers had dishonestly breached the duty of good faith. I am satisfied that the judge was entitled to hold that there was such a breach here, essentially for the reasons he gave. This was a conscious and cynical attempt to free capital from the constraints of the regulator to be used for a range of purposes some of which were wholly and manifestly unrelated to the interests of EIC. These included substantive payments in excess of £6m. to Mr. Flowers himself and an investment by EHL into a gastro pub. Mr. Flowers was aware that no services were provided by EIG pursuant to the MSA, and he sought successfully to conceal this fact from the regulator. Such capital as was returned was on a drip-feed basis as and when required to maintain EIC on what was described as a "break-even" basis. Moreover, as the judge pointed out, these payments continued even in the later years when EIC was making significant losses. All these factors justify the conclusion of the judge that Mr. Flowers had not acted in the best interests of the company, and he must have appreciated that he had not. To use the language of Lord Millett in the *Three Rivers* case (43), these were the facts which "tilted the balance" in favour of an inference of dishonesty.

100 I would be particularly reluctant to intervene in circumstances where the judge's conclusions depended in part on his assessment of the witnesses. His view of Mr. Flowers was that his evidence lacked "integrity, coherence and credibility" (2034/GSC/008, at para. 548). Mr. Poole suggested that the judge had in fact allowed his negative view of Mr. Flowers in the witness box insidiously to influence his analysis of the facts. He relied upon some observations of Robert Goff, L.J. in *Armagas Ltd.* v. *Mundogas SA ("The Ocean Frost")* (3) ([1985] 1 Lloyd's Rep. 1, at paras. 56–57), cited with approval by Lord Mance in *Central Bank of Ecuador* v. *Conticorp SA* (10) ([2015] UKPC 11, at para. 8), to the effect that, particularly in cases of alleged fraud, it is important to test the veracity of a witness by reference to documents, motive, and the likely probabilities of the matter. I respectfully agree with these comments, but that is precisely what the judge did. He did not simply rely upon his general impression of Mr. Flowers' truthfulness; as I have pointed out above, his analysis and

conclusions were significantly based on contemporaneous documents, not least incriminating emails. Furthermore, in reaching this conclusion the judge had to evaluate a range of factors, and courts are particularly reluctant to hold that a judge's conclusions are wrong in those circumstances: see the judgment of Clarke, L.J. in *Assicurazioni General SpA* v. *Arab Ins. Group (BSC)* (5) ([2002] EWCA Civ 1642, at paras. 16–20).

101 The judge also found, relying on essentially the same facts, that Mr. Flowers was in breach of his duty of care to the company. I would uphold that finding. In practical terms, this adds nothing to the finding on fiduciary duty. The latter gives a potentially wider range of remedies.

Dishonesty and Ponzi schemes

102 The liquidator alleged that EIC had been operating an "insurance Ponzi scheme," although the judge did not adopt that description of what had occurred. Nonetheless it understandably aggrieved Mr. Flowers for the wrongdoing to be so described, and I think it right to make some observations about it.

103 A Ponzi scheme has overtones of very serious business malpractice on a major scale. The basis of such schemes is that early investors are paid from the moneys invested by later investors but there is no substance to the business itself. The business is illusory but can keep operating whilst investors continue to contribute new funds. The justification for this characterization was apparently the fact that premiums were paid ahead of capital, from which it was inferred that some liabilities would have been paid from new premium. Even if that were so—and it seems likely that it was on occasions, although that is strongly disputed by Mr. Flowers—that does not in my view begin to justify this somewhat brutal description of the way the company was run, or the nature of the dishonesty involved.

104 Whilst the judge found that the MSA scheme and some related transactions were dishonest, this was not a sham business, and it is unjust to say that Mr. Flowers was indifferent to its success. Had that been the case, there is no reason why there would have been any repayments or reimbursements to the company from the MSA moneys. Perhaps more importantly, Mr. Flowers himself gifted a few businesses to the Enterprise group in 2015, which he alleged were worth some £6m. The figure has been disputed, but it was on any view a substantial sum designed, at least in part, to help meet the capital requirements of Insolvency II. This is not the action of someone operating a rogue business. No doubt it can be said that it was in Mr. Flowers' interest to keep the business afloat, but that is hardly a ground for criticism.

105 Mr. Flowers has been found to have bent the rules to his own advantage. He has been willing to deceive the regulator and make unlawful

payments, not least to place funds outside the regulator's control and thereby to enable funds to be paid to himself. That was dishonest, but it is a far cry from practising fraud on a Ponzi scale.

106 Mr. Poole submitted that the gifts made by Mr. Flowers ought to have been referred to by the judge and should have weighed with him when assessing dishonesty. It would have been desirable had they been mentioned, at least in the context of knowledge of insolvency, as I explain below. But these gifts were not in my view relevant to the question of whether the MSA and certain related transactions were dishonest. They did not bear upon the factors which rendered those transactions a dishonest breach of fiduciary duty.

Echelon, PIE and other transactions

107 I will briefly consider other specific transactions which the judge held were in substance further examples of the improper transfer of funds from EIC to EIG.

Echelon

108 This transaction concerned the payment to EIC by Echelon of £300,000 for agreeing to reinsure an insurance risk. Two days later the money was transferred to EIG. The auditors questioned this and were told that in reality EIG did all the work on behalf of EIC, although there was no invoice demonstrating this assertion, nor any other contemporary evidence supporting it. Indeed, the relevant EIC board minutes record the agreement and note that the money had been paid but make no reference to any role played by EIG. Mr. Flowers contended that EIG had in fact carried out time-consuming work on this transaction, and EIG's accounts for 2009 were signed off on this basis. In his evidence he claimed that in doing that work he was wearing his EIG hat. The judge rejected that, not least because he was employed and paid by EIC, the party to the agreement. The natural inference from all the evidence was that he was working for EIC.

109 The following year EIG's accounts were queried by the Commission not on the basis that EIG had not done the work, but on the basis that they would need a licence to do it. The explanation now changed, and Mr. Newing said that EIG had only done relatively minor work. Subsequently, in March 2012, an invoice was falsely constructed, one purporting to have been produced in February 2009, and stating that the fee had been paid for services with respect to the Echelon agreement. The judge rejected the claim that this obviously dishonest backdating had been done at the instigation of the Commission. Moreover, no relevant board minute was ever produced approving the payment, as Mr. Flowers had suggested was the case.

110 The judge held that this was another example of the transfer of money out of EIC for an improper purpose. He again rejected the proposition that the triangular arrangement, and the credit facility it was said to create, could justify it. The judge also found that it was dishonest. He said this (2034/GSC/008, at para. 720):

> "In all the circumstances and in a similar way to the MSA, Mr. Flowers breached his fiduciary and common law duties when he allowed payment of this £300,000 fee to EIG. Mr. Flowers' subjective intention was a dishonest one, and he acted in bad faith because this payment was not made for proper services provided to EIC by EIG, but to move money into EIG quite possibly so that a loan could be repaid."

111 The case now argued is that Mr. Flowers honestly thought this was in the interests of EIC. However, the MSA analysis applies equally here. There was no justification for giving the money away, and the alleged benefit of providing a capital facility did not provide one.

The Sails

112 EHL owed money to one of its shareholders, RHL, in broadly the same sum as the value of a flat in Gibraltar in a block called The Sails. The flat was owned by EIC. EHL gave EIC cash for the property and it was transferred to RHL (one of EHL's shareholders), to whom EHL was indebted. The argument was that the cash was more valuable to EIC than the property had been because not all the value of the property could be treated as an asset for solvency purposes. The cash was paid out of the 8% fee which EIC had paid via EIG to EHL and in fact was paid to EIG only two days before money for the property was returned to EIC. The judge found that in substance all that had happened was that EIC had paid for its own property in order to allow EHL to repay its debt.

113 The judge held that this was "nothing more than a feature of the MSA claim and shows the abuse which took place under the guise of the MSA." Mr. Poole submits that if, as he alleges, the judge was wrong in treating the triangular model and capital facility as an improper and dishonest arrangement, then the judge's analysis of this transaction is flawed also. The converse is that if the judge was right, as I have found that he was, then the use of EIC's money to buy its own property could not conceivably be in the company's interest, even accepting that it had the small benefit of increasing available assets for solvency purposes.

PIE

114 For some seven years from 2004 to 2012, EIC paid EIG for the use of the PIE system. This was software which facilitated the selling of "after the event" ("ATE") insurance policies. The payments increased during

each of those years and for the last two years when payments were made, they were each for £900,000. The liquidator claimed that there was no proper rationale for any of these payments and that the true purpose was to "release cash" from EIC, as Mr. Flowers had described it in an email to Mr. Martinez, one of the group directors, on June 1st, 2009.

115 The judge did not accept the liquidator's submissions in full. He accepted that there had been a justification for the payments up until 2009. This was not least because the system was genuinely useful to EIC when its principal business was to sell ATE insurance policies, which was the position until around 2010 at which point the motor business became the principal underwriting activity. However, PIE was far less useful for the motor business and yet the payments were increased when one would have expected them to diminish significantly.

116 In the light of these considerations, the judge concluded that from around 2009 the payments were excessive. He held that, as with the MSA payments, there was a dishonest breach of duty, namely a deliberate intention to use these payments to release cash from EIC irrespective of any benefit to EIC. The judge felt unable to determine the extent of the overpayments and left that for another occasion.

117 There is no challenge to the factual finding that the payments from 2009 were excessive. The only argument on appeal is that, as with the MSA payments, it was in the interests of EIC for moneys to be released in this way to facilitate the injection of fresh capital. It was a variant of the triangular model. Since I have found that the judge was entitled to conclude that the MSA payments were a breach of fiduciary duty, and that the triangular model provided no justification for them, it follows that he was entitled to reach the same conclusion here.

118 There were findings by the judge of breach of fiduciary duty with respect to other payments made by EIC but they are in essence variations on the same theme. The judge relied upon them as showing an abuse under the guise of operating the MSA. I will briefly mention one of them. It relates to moneys which were extracted from EIC to pay for Mr. Flowers' divorce. There was a flurry of emails in which Mr. Flowers indicated to Mr. Newing that he needed to maximize his income from EIG by a certain date in 2012 in order to finance his divorce settlement. Relevant payments were subsequently made. The judge treated this as yet another example demonstrating how the MSA had become an instrument to channel funds to Mr. Flowers and others. It is also pertinent that in one of these emails, Mr. Flowers himself referred to "dividending" some of EIC's capital. The judge concluded that it was plain that Mr. Flowers appreciated that the payments made were "dressed up dividends," in the sense of being dividends in reality—without of course any consent to such payments from the Commission—albeit ostensibly payments for consultancy services or

directors' fees. The judge concluded that these payments had nothing to do with the best interests of EIC and everything to do with Mr. Flowers' requirements for capital. The judge's findings on this transaction have not been challenged on appeal.

119 The common theme of all these transactions is that they demonstrate a cavalier, one might say reckless, indifference to the regulator's requirements, and a willingness to treat EIC funds as available for whatever purpose was close to hand, whether or not that purpose was of any benefit to EIC. The MSA payments and the excessive PIE payments were the dishonest means of extracting the money from EIC. It was seen, as the judge put it, as a "cash cow" to be milked when necessary.

Ratification

The law

120 In his defence to the breach of duties, Mr. Flowers has sought to assert that his conduct has been ratified by the unanimous approval of all the shareholders. The effect of ratification is that even if a director's conduct was initially unlawful, it becomes adopted by the company as its own act following ratification. The company cannot thereafter complain of any breach of duty arising out of the original misconduct.

121 The company organ which at common law is empowered to ratify breaches of duties by directors is the general meeting of shareholders, unless the articles stipulate otherwise. It is not suggested that the articles of EIC did so in this case. There was no resolution passed by EIC ratifying Mr. Flowers' conduct, whether a formal written resolution or one passed at a general meeting. However, a formal resolution is not required if there is the unanimous informal consent of all the company's shareholders. This is known as the principle in *In re Duomatic Ltd.* (16), although its origins predate that case. In *Ciban Management Corp.* v. *Citco (BVI) Ltd.* (12) ([2020] UKPC 21, at para. 31), Lord Burrows, giving judgment for the Judicial Committee of the Privy Council, described the principle as follows:

> "The *Duomatic* principle is, in short, the principle that anything the members of a company can do by formal resolution in a general meeting, they can also do informally if all of them assent to it."

This unanimity rule had been recognized in the seminal case of *Salomon* v. *Salomon & Co. Ltd.* (37) ([1897] A.C. at 57), where Lord Davey succinctly observed with respect to the company in that case that it was "bound in a matter intra vires by the unanimous agreement of its members." This is a principle of general application. Its effect is that any procedural requirements relating to the making of a formal resolution can be overridden by this informal mode of ratification.

122 An important question is what is meant by assent or agreement. This was considered by Neuberger, J. in *EIC Servs. Ltd.* v. *Phipps* (17) ([2003] EWHC 1507 (Ch), at para. 122), who noted that the principle is satisfied providing:

> "[A]ll members of the group, being aware of the relevant facts, either give their approval to that course, or so conduct themselves as to make it inequitable for them to deny that they have given their approval. Whether the approval is given in advance or after the event, whether it is characterised as agreement, ratification, waiver, or estoppel, and whether members of the group give their consent in different ways at different times, does not matter."

123 Approval is, therefore, a matter of substance, not form. It is not enough, however, that the shareholder is merely told of the breach: some manifestation of acceptance is required. Accordingly, as Hoffmann, L.J. observed in *Re D'Jan of London Ltd.* (15) ([1994] 1 BCLC at 564), in the context of proceedings brought by a liquidator:

> "It is not enough that they probably would have ratified if they had known or thought about it before the liquidation removed their power to do so."

124 Furthermore, as Neuberger, J. pointed out in *Phipps* (17), the giving of assent is conditional on the members being fully informed of the breach in question; they must be "aware of the relevant facts" ([2003] EWHC 1507 (Ch), at para. 122). These must at least be the material facts which are necessary to enable the shareholders to take a considered view on whether they are willing to approve or accept the transaction in question and adopt it on behalf of the company.

Non-ratifiable breaches of duty

125 Lord Davey's observation in *Salomon* (37) that the unanimous agreement of the members can bind the company on any *intra vires* matter is not always true. Not all breaches of duty can be ratified. It follows that any purported ratification of such breaches, whether by way of formal resolution or informal unanimous acceptance, will be a nullity and will not bind the company (or a liquidator acting on behalf of the company). The following are potentially relevant exceptions.

126 First, plainly it can apply only to *intra vires* acts in the broad sense of acts which the company is entitled to perform. If the company cannot do an act itself, it cannot be empowered to authorize or ratify that same act done by a director. This exception applies to acts which are not permitted either by the company's constitution itself (the narrow concept of *ultra vires*) or by the constitution or the general law (the wide view of *ultra vires*). With the relaxation of the *ultra vires* rule which allows companies

to have unlimited capacity, the former will only arise in circumstances where the company chooses to impose restrictions on its capacity. However, the latter, in so far as it relates to acts forbidden by the general law, retains some importance. In *Madoff Securities Intl. Ltd.* v. *Raven* (26) ([2013] EWHC 3147 (Comm), at para. 268), Popplewell, J. indicated some of the effects of this exception:

> "[T]he *Duomatic* principle does not permit shareholders to do informally what they could not have done formally by way of written resolution or at a meeting: *Re New Cedos Engineering Co Ltd* [1994] 1 BCLC 797, 814g–h; *Atlas Wright (Europe) Ltd v Wright* [1999] BCC 163, 174G–H. Accordingly the principle can not apply to relieve the directors of liability in respect of transactions which are ultra vires in either the narrow or the wider sense in which the expression is used (see *Rolled Steel* [1986] Ch 246 at 276–278, 302–3). Therefore this defence would not be capable of applying to breaches which amounted to unlawful payment of dividends (see *Aveling Barford* at 630–631, 632; *Secretary of State for Business Innovation and Skills v Doffman* [2011] 2 BCLC 541 at [41]). Nor can it provide a defence where there has been the exercise of powers for an improper purpose: *Rolled Steel* at 277C. In each case the shareholders in general meeting could not lawfully do that which they have approved the directors in doing."

127 Second, no act can be ratified if it is dishonest, as indeed Buckley, J. recognized in *Duomatic* itself. As Lord Burrows said in *Ciban Management* (12) ([2020] UKPC 21, at para. 43):

> "[T]he *Duomatic* principle cannot be used where there is relevant dishonesty. For example, in *Bowthorpe Holdings Ltd v Hills* [2002] EWHC 2331 (Ch), [2003] 1 BCLC 226, Sir Andrew Morritt V-C said the following at para 50:
>
>> '. . . the transaction must be bona fide or honest. This, in my view, is demonstrated by the qualification of Viscount Haldane in *AG for Canada v Standard Trust* [1911] AC 498, 505 that "the case was not . . . a cloak under which a conspiracy to defraud was concealed", by Younger LJ in *In re Express Engineering Works* [1920] 1 Ch 466, 471 that "no fraud is alleged in respect of this transaction", and by Lawton LJ in *Multinational Gas v Multinational Services* [1983] Ch 258, 268 that the members must act in good faith. Thus, in *In re Duomatic Ltd* [1969] 2 Ch 365, 372 Buckley J cited with approval the view of Astbury J in *Parker and Cooper Ltd v Reading* [1926] Ch 975, 984 that the transaction must be both intra vires and honest.'"

128 It is not entirely clear why the members acting unanimously should not be able to ratify any decision by a director which the company itself

could take, as long as creditors are not adversely affected, even if it means being willing to forgive dishonest actions. But as Flaux, J. observed in the *Madoff* proceedings at an interlocutory stage ([2011] EWHC 3102 (Comm), at para. 123), where this argument was unsuccessfully advanced, whatever the juridical basis for this principle, there is now a clear body of authority supporting it whether creditors are affected or not. Moreover, in a comment of particular relevance to this appeal, he observed that a purported ratification in such circumstances will not be binding:

> "[N]ot only *Bowthorpe Holdings* itself, but a number of other cases, including *Cox v Cox*, recognise the existence of a wider exception to the effect that a transaction can be impugned by the company if it is not honest, bona fide and in the best interests of the company."

129 Third, there can be no ratification of any decision taken in breach of a duty owed towards creditors. This has been confirmed in the decision of the Supreme Court in *BTI 2014 LLC* v. *Sequana SA* (7). The logic is that there can be no justification for allowing shareholders to ratify duties which are not exclusively owed to them. The classic example where this occurs is where a company is insolvent, or insolvency is imminent. The liquidator claims that EIC has been insolvent since 2010 and that therefore no payments made after that date can lawfully be ratified. I deal with the question of insolvency later in this judgment and shall defer considering its implications for ratification until then.

The decision of the judge

130 The judge held that ratification could not be effective for two reasons (2034/GSC/008, at paras. 908–909). First, he held that as a matter of fact there was no informed consent. The shareholders would have needed to know that no services were provided by EIG for the sums received from EIC, and that the PIE payments were excessive. Since Mr. Flowers had sought to argue to the contrary, there was no evidence that the shareholders did know this.

131 Second, after an extensive analysis of a mass of evidence, including expert evidence, the judge concluded that in fact EIC had been insolvent since June 30th, 2010 and that Mr. Flowers ought to have known that this was the case. It followed that the duty to have regard to the interests of creditors arose at that time, and accordingly there could be no ratification of any payments made thereafter.

132 Surprisingly, the judge did not in the summary of his conclusions on ratification refer in terms to the fact that there could be no ratification because, as he had found, the transactions had been dishonest. This appears to have been an oversight. He had referred much earlier in his judgment (*ibid.*, at para. 66) to the fact that the transaction to be approved must be

intra vires and honest. The logic of his findings, therefore, engages this exception also.

Discussion

133 First, it is important to appreciate who, in the context of this case, needs to ratify the relevant acts. In the case of the breaches of duty owed to EIC, there was only one shareholder, EHL, a corporate shareholder. Unless the articles said otherwise (and no-one suggested that they did) the company organ which would act to bind the company with respect to ratification would be the board of directors. There was no board resolution, however, and so reliance was placed on the informal unanimous consent of the directors. Although *Duomatic* (16) developed as a principle applicable to decisions of shareholders, it has been recognized that it can also, in an appropriate case, apply to decisions of the board of directors; see *Runciman* v. *Walker Runciman plc* (36). So, the question was whether the directors could be said unanimously to have approved the breaches of duty. Mr. Poole accepted that this was the correct approach.

134 The directors of EHL varied over time. Between 2010 and 2014 they were Mr. Flowers, Mr. Cruz, Mr. Jacobson and Mr. Martinez. The first two gave evidence that they knew of the payments and why they were made, although Mr. Cruz understood that since EIG was the formal employer of staff, it was providing services, albeit of an expanded nature, to EIC. Mr. Jacobson said that he relied upon what other executive directors told him about the justification for the payments from EIC to EIG. Critically, neither of them appreciated that no relevant services had been provided to EIC pursuant to the MSA. Similarly, there is no evidence that they appreciated that the PIE payments were excessive. Accordingly, they were not properly informed of what they were supposed to be ratifying. In any event, there is still no unanimity without the fourth director having assented also, and there was no evidence at trial from Mr. Martinez. One cannot infer approval from silence.

135 Messrs. Longstaff, Martinez and Evans also became directors in late 2014. I understand that to be in addition to the original four. If so, whether these new directors personally ratified the relevant payments made after they became directors is immaterial since there could be no ratification without unanimity of all the directors. In any event, they cannot be said to have adopted the MSA or PIE payments. They were not called as witnesses, although it is alleged that their witness statements had asserted that they knew and approved of these payments and that it should be assumed that they would have given evidence consistent with those statements. This comes nowhere near establishing ratification. First, we cannot assume that they would come up to proof had they given evidence. Second, again there is no evidence that they ever appreciated that the MSA payments were made for no good consideration or that the PIE payments were excessive.

Third, there is equally no evidence that they ever made any assent or acceptance clear, whether by express words or conduct or otherwise, before the company was wound up. As Hoffmann, L.J.'s observations in *Re D'Jan* (15) make clear, it is too late for them to assert after the company has been put into liquidation that they would have been prepared to ratify, if asked to do so.

136 Second, the finding of dishonesty means that the payments made from EIC to EIG were not ratifiable breaches of duty in any event. As I have said, although the judge did not specifically rely on this exception, it inevitably applies given his findings.

137 In my judgment there is also a respectable argument for saying that the company could not ratify because it could not itself lawfully have made these payments, thereby engaging the *ultra vires* exception discussed above. In substance these payments were akin to dividends, and it is highly likely that they were not paid out of distributable reserves given the fact that for most of this period the company was not making any profits. Moreover, there is in my view a respectable argument at least that it would not be lawful within the meaning of this principle for dividends to be paid without the required Commission approval and/or in circumstances where the payments jeopardized the protection for creditors which the RMM was designed to achieve: see by analogy the decision of the Court of Appeal in *Precision Dippings Ltd.* v. *Precision Dippings Marketing Ltd.* (31). But those are arguments for another day.

138 I am not, however, ultimately persuaded that the judge was right to find that the insolvency exception applied. However, this aspect of the ratification argument requires a consideration of whether EIC was insolvent prior to 2016, and whether Mr. Flowers either knew or ought to have known that it was. The liquidator says that he ought to have known that it was insolvent from June 30th, 2010 onwards. The insolvency issue has some connection with the alleged negligence with respect to the Icebreaker policies, and I shall defer consideration of this part of the case until Icebreaker has been considered.

Damages

139 We are not concerned in this appeal with the assessment of damages arising from the breaches of duty with respect to the MSA and PIE payments; that has been left for later determination. There are, however, two areas of principle which have arisen.

140 First, Mr. Flowers submitted that he ought to be excused from any liabilities by virtue of s.477 of the Companies Act 2014 (or its predecessor, s.378 of the Companies Act 1930 if it was the provision in force at the material time) which excuses a director from any defaults if he has acted "honestly and reasonably and ought fairly to be excused." That exception

plainly does not apply here in the light of my conclusion, upholding the judge, that Mr. Flowers was neither honest nor were his actions reasonable.

141 Second, an issue of principle arises as to whether certain capital paid into EIC should be credited against its loss. By the end of the hearing below, EIC had accepted that credit ought to be given for rebates made with respect to MSA payments amounting to some £12.4m.

142 The judge considered two other payments made by EHL into EIC. The first was a payment of some £8.3m. paid into EIC for new shares, the money having been acquired by EHL through the operation of the triangular model. The second was the subscription for new shares in the sum of £24m., paid out of a loan which EHL had taken on the Frankfurt bond market, again where EIC was the original source of funds.

143 In *Tiuta Intl. Ltd.* v. *De Villiers Surveyors Ltd.* (44) ([2017] UKSC 77, at para. 12), Lord Sumption explained the general rule as follows:

> "The general rule is that where the claimant has received some benefit attributable to the events which caused his loss, it must be taken into account in assessing damages, unless it is collateral. In *Swynson Ltd v Lowick Rose LLP (in liquidation)* [2017] 2 WLR 1161, para 11, it was held that as a general rule 'collateral benefits are those whose receipt arose independently of the circumstances giving rise to the loss.'"

144 The judge relied upon the following passage from the judgment of Lord Walker, giving judgment in the Privy Council in *Villeneuve* v. *Gaillard* (45) ([2011] UKPC 1, at para. 93), which states the converse of Lord Sumption's observation in the sense of saying what the general principle does not cover:

> "There is no general principle that in assessing either common law damages or equitable compensation for breach of fiduciary duty, losses should be reduced by adventitious gains in separate transactions between the same parties: *Brown v KMR Services Ltd* [1995] 4 All ER 598, 640–641 (Hobhouse LJ); *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515, 538 (Brightman J)."

145 In my view the "adventitious gains in separate transactions" would certainly fall within the scope of Lord Sumption's "collateral benefits."

146 The judge held that the purchase of shares was a separate transaction from that causing the loss. Mr. Flowers had not sought to suggest that it was other than a genuine transaction, and EHL had received value, in the form of shares, for the sums they paid. Accordingly, none of the losses had been ameliorated by these payments.

147 I do not accept that analysis. First—and the judge would not, I suspect, have disputed this—there was plainly a close link between the

payments made to EHL via EIG and the sums paid back to EIC. This was always a feature of the triangular model, albeit that there was no legal obligation binding EHL to pay anything into EIC. Indeed, in the context of considering the allegation that EIC had unlawfully provided financial assistance for the purchase of its own shares—an allegation which the judge rejected—the judge held (2034/GSC/008, at para. 863) that "the prospect of capitalising EIC from the MSA and PIE payments was on Mr. Flowers' radar from the outset." These were not, therefore, unrelated transactions; they were, to use Lord Sumption's words, payments which were "attributable to the events which caused his loss." I accept, however, that even though they were related transactions, the payments should not be taken into account if they were not simply capital injections into EIC but were payments made for good consideration giving a commercial benefit to EHL.

148 Second, and in my view critically, it is unreal to say that when EHL received consideration for the shares, it received something of value. EHL was always the sole shareholder of EIC, and the addition of further shares gave it nothing of substance. This was an accounting device which gave no more benefit to EHL than if it had simply invested the money directly into its subsidiary without receipt of shares or anything else. The fact that shares were received simply diluted the value which EIC's shares would have had if no shares had been received. The payments increased the value of EIC and thereby reduced the amount of loss suffered from the MSA and PIE payments. As Lord Browne-Wilkinson pointed out in *Target Hldgs. Ltd.* v. *Redferns* (42), equitable compensation is designed to make good the loss suffered. It would be inequitable to fail to give credit for these payments.

149 In short, in my judgment, the payments made were not collateral benefits but were directly attributable to the events causing the loss, *i.e.* the unlawful payments made indirectly to EHL; and their effect was to provide a direct benefit to EIC without any countervailing benefit to EHL. They should be offset against the losses suffered.

150 Mr. Jones advanced an alternative argument as to why no credit should be given. As I understood it, the submission was that in reality EHL was merely giving EIC its own money back. It was EIC's money all along which secured the moneys from which the payments for the shares were made, and EIC was entitled to them. That may be so, but the fact is that some of the money was returned, and the effect was to reduce the amount of the loss. An alternative way of putting it would be to say that it has in fact received some of the capital acquired with its money. Either way, it should give credit for it. If Mr. Jones' argument were correct, all the money could have been returned via EHL and yet EIC would retain a claim in damages for the same sum again. That would not be making good the loss; it would be an inequitable windfall for EIC.

Initial share capital

151 Mr. Poole argued that there should be a further credit given for part of the initial share capital of £2.5m. which was introduced into EIC by EHL before EIC started to trade. £1m. of this sum was subject to a bank loan which was secured by a charge on the income generated by EIG, *i.e.* the payments made under the triangular model. A further £650,000 was raised by EHL in 2006, also serviced by the payments from EIC to EHL via EIG. The submission is that since the borrowed moneys were secured by the EIC payments, they ought to be treated as credits to be set off against the losses.

152 I would reject that submission. The start-up capital cannot be a credit with respect to moneys wrongfully taken out subsequently. When the loans were taken out, it may well have been anticipated that sums would be raised through the triangular model to pay for them. But it would not have been known, either when the payment was made or the loan was secured, that the model would be used in an abusive way and that no services would be provided for the payments to EIG. These were not, therefore, benefits which were "attributable to the events which caused the loss."

Limitation periods

153 I can deal with this briefly. The normal limitation period for a breach of trust is six years. If that were applicable, no claims relating to MSA or PIE payments could be made with respect to transactions occurring before October 9th, 2011. However, there are a number of provisions under the Limitation Act 1960 which extend time. These include s.26(1)(a), which disapplies the time limits with respect to a "fraudulent breach of trust to which the trustee was a party"; and s.26(1)(b), which disapplies time limits with respect to trust property "received by the trustee and converted to his own use." The former would apply to MSA and PIE transactions; the latter to the recovery of sums which Mr. Flowers received from EIG. It is trite law that these provisions apply to company directors and that the concept of a fraudulent breach of trust means a dishonest breach of trust. It follows that once dishonesty has been established, these provisions are applicable. That was the conclusion of the judge, and it is plainly correct. In so far as the claim for damages is based on breach of fiduciary duty, therefore, no time limit at all applies, although these provisions do not extend time with respect to the common law negligence claim.

154 The judge also found that s.32(1)(a) of the 1960 Act applied. This disapplies the limitation period where the action is based on the fraud of the defendant and the fraud is unknown at the time. The limitation period does not begin to run until the fraud is discovered or could with reasonable diligence have been discovered. The significance of this provision in this case is that, unlike s.26, it could extend time with respect to the common law claim, although unlike s.26, it does not remove the limitation period

altogether. Time runs in the common law claim from the date when damage accrues.

155 The judge held that this provision was applicable because the liquidator could not have discovered the fraud prior to his appointment in July 2016 and he acted with appropriate diligence thereafter. But the question is not whether the liquidator could have discovered it since he is not the claimant; it is whether EIC could have done so. I doubt whether any members of the board of EIC were ignorant of the actual relationship between EIC and EIG and in any event, if they were, they could readily have discovered it with reasonable diligence well before the liquidator was appointed. However, even if the judge was wrong about this, nothing turns on it since the fiduciary claims can be pursued with respect to all dishonest payments, even if the common law claims are subject to the six-year limitation period.

Icebreaker

Introduction

156 EIC wrote some 400 policies with respect to what was termed "Icebreaker 2" (so called because it was a revised version of an earlier scheme, Icebreaker 1). The judge found (2034/GSC/008, at para. 806) that Mr. Flowers was "the dominant director, negotiator and underwriter" of these bespoke policies. Icebreaker 2 was a complex tax avoidance scheme designed to secure tax advantages for investors who joined that scheme. The policies insured the policy holder against certain investment losses which might result from the operation of the scheme. They were closely interlinked with the scheme itself and the policy was one of the documents made available to prospective investors, although it was not obligatory for an investor to take out a policy. The policies were sold from May 2009 to April 2013.

157 EIC did not provide for any reserves against the potential liabilities arising from these policies. Mr. Flowers asserted that this was justified because EIC was, for various reasons, not at risk by incepting them. The liquidator alleged that substantial reserves ought to have been included in the balance sheet for the years 2010 onwards. He contended that Mr. Flowers was in breach of both his fiduciary duty to the company and his duty of skill and care in failing to take advice as to the degree of risk and the appropriate reserves. The liquidator relied upon the expert evidence of Dr. David Brown, an experienced actuary, as to what reserves ought to have been provided had a proper assessment of risk been undertaken. In Dr. Brown's view, these should have increased as the years progressed, partly because more policies were sold and therefore potential liabilities increased, and partly because it became ever more apparent, as a result of litigation over Icebreaker 1 and later Icebreaker 2, how significant the risks were.

158 The judge held that there was no breach of fiduciary duty because Mr. Flowers appeared to have convinced himself, however foolishly, that EIC would not be liable under the policies, and therefore he had not acted in bad faith in failing to make any reserves. However, he did find that Mr. Flowers was negligent and in breach of the duty of care. Mr. Flowers had failed to take proper professional advice as to the nature and extent of the risks and how they should be reflected in the reserves. Furthermore, although he had taken legal advice which resulted in a clause being drafted (cl. 11.4) which excluded liability in certain circumstances, he had been negligent in the way he had sought that advice. The judge accepted the expert evidence of Dr. Brown as to what steps ought to have been taken by a responsible insurer, and what reserves ought to have been made in the accounts with respect to Icebreaker 2 in each of the years from 2010 to 2015. (These figures are highly relevant to the issue of insolvency, and I will consider them in that context.)

159 Mr. Flowers appeals against the judge's decision. He denies that he was negligent and maintains his view that there was in fact no risk of any liability arising under these policies, but that even if there was, he had acted reasonably on legal advice in taking the position he did.

160 The question of what damages EIC has suffered as a consequence of these breaches of duty has been left for a later hearing. The re-amended particulars of claim, at para. 72.1, claim damages on two distinct limbs. They allege that had Mr. Flowers (and indeed all the directors) acted with due care at the material time, either it would have become clear that the underwriting of the policies should not have been undertaken, in which case they would not have been issued and no liabilities would have arisen; or the directors would have had to provide appropriate reserves, in which case it would have become apparent that the company was insolvent, and it would have been wound up far earlier than it was, thereby reducing the losses to creditors (re-amended particulars of claim, at para. 72.1). These are not claims in the alternative. EIC could establish, for example, that but for the negligence, it would have been declared insolvent earlier but Icebreaker 2 policies may have been sold both before and after that date. Under the first limb, there will be liability for losses incurred in relation to policies underwritten prior to the date when insolvency would have occurred. Loss resulting from policies underwritten after that date would fall under the second limb, although there would almost certainly be other losses also arising from the continued operation of the insolvent company.

The Icebreaker 2 scheme

161 The Icebreaker schemes involved making investments in the arts sector. Generally, it is not permissible under tax law to set off losses in one area of economic activity against gains made in another unrelated venture; they are independently treated. However, there are exceptions where

government policy is to encourage investment in certain fields, one of which is in the creative sector. The schemes sought to take advantage of these provisions.

162 In all the Icebreaker schemes, investments were made through a limited liability partnership ("LLP"), and the investor became a member of the LLP. There were a number of these special purpose LLPs, a separate one for each distinct investment project. An LLP would acquire, typically by obtaining an exclusive licence, the relevant intellectual property rights relating to, say, a book, film, or musical composition, generally for a very modest fee. It would then put the product into the hands of an exploitation company who would manage and develop the project with the ostensible aim of realising a profit for investors. The reason for investing through an LLP is that provided it is carrying on a trade, profession, or business "with a view to profit," the activities of the LLP are, for tax purposes, treated as carried on by the members: s.863 of the Income Tax (Trading and Other Income) Act 2005. The members can then take advantage of the principle that losses can be set off against other independent gains, termed "sideways loss relief," provided they satisfy certain requirements.

163 In this case, HMRC conceded that the investment was with a view to profit so the members making a loss on the investment (which was virtually all of them) could in principle seek to take advantage of the sideways loss relief. There are, however, a number of conditions which have to be satisfied if the relief is to be available, one of which is that the investment can properly be described as a "commercial venture": see Income Tax Act 2007, s.66.

164 The investment scheme itself was complicated, not least because although the investor might put, say, £100 into the LLP, only £20 was actually put at risk. The other £80 was loaned from a bank and the system was set up in a complex way to ensure that the members received guaranteed returns sufficient to enable them to service and repay these loans, without any risk to them or the bank. A more detailed explanation of a typical scheme (they vary to some extent in detail), assuming a £100 investment, was given by Nugee, J. in the Upper Tribunal (Tax and Chancery Chamber) in *Seven Individuals* v. *HM Revenue & Customs* (38) ([2017] UKUT 132 (TCC), at para. 11):

> "Of that 100 the members contribute 20 from their own resources. The other 80 is borrowed by the members from a bank . . . That bank borrowing was on full recourse terms, or in other words the individual members were personally liable to repay the 80 to the lending bank. The LLP takes the 100 and pays 5 to a management company, Icebreaker Management Ltd ('IML'). That 5 is in part what is called an advisory fee and in part an administration fee . . . The LLP pays the remaining 95 to a company that can be referred to as the principal

exploitation company . . . Shamrock agreed to pay a large part of the 95 (say 90) to a production company which would be responsible for producing the end product, be it a music CD, a book, or some other product. The production company simultaneously agreed to acquire a share of the revenues from exploitation of the product from Shamrock, the price for doing so being say 80. The net effect of those two agreements was that Shamrock paid 10 to the production company, leaving it with 85 of the 95 paid to it. Shamrock put 80 of this (or in one case 80 of its own money) on deposit as collateral for the issue of a letter of credit. The interest paid on the deposit of 80 is used by Shamrock to pay an income stream by quarterly payments to the LLP and that matches the quarterly interest payments which the members of the LLP are obliged to pay to the lending bank for the initial borrowing of the 80 to fund their contribution to the LLP."

165 The sole reason for ostensibly making the capital investment £100 rather than the £20 actually put at risk was that, if this figure were accepted by the Revenue, it would materially increase the losses in respect of which sideways loss relief could be claimed. As Nugee, J. said in *Acornwood* v. *H.M. Revenue & Customs* (1) ([2016] UKUT 361(TCC), at para. 85):

"The borrowing of the 80 and its payment to Shamrock by the LLP was in short artificially designed to multiply the losses. There is no commercial difference between the members paying 15 for Shamrock's services without having borrowed 80 and without any rights to guaranteed repayment of the 80, and the members paying 95, of which they have borrowed 80 and are guaranteed to be repaid 80 (save for the extra costs in terms of margin and arrangement fees in the latter)."

166 The scheme was based on the premise that there would be losses in the first year. This was virtually inevitable given that all the relevant expenditure would be made in that year with no, or virtually no, anticipated income in return. This was known by EIC: cl. 3 of the policy itself referred to the "anticipated first year trading losses of the LLP." The claim for the losses incurred would be made by the LLP in its tax return for that year. They would only be permitted if the losses were incurred wholly and exclusively for the purposes of the partnership's trade. The individual member would then claim sideways relief based on his or her share of the loss, the amount being determined by reference to the losses which HMRC had allowed the partnership to claim.

The terms of the insurance policy

167 The insurance policy effectively guaranteed the policy holder a return of the policy holder's actual investment (*i.e.* the full capital contribution minus the loan) at the end of five years, adjusted for any profits received from the LLP. EIC was off risk if either:

(1) At the end of five years, the member's proceeds from the investment (essentially the investor's share of the LLP's gross income) equalled or exceeded the insured amount; or

(2) HMRC agreed, or a relevant court or tribunal finally determined, that the first-year trading losses of the LLP were allowable for tax purposes and that the LLP's tax return for the relevant year (*i.e.* the year ending April 5th, 2010) was correct.

In addition, cl. 11.4 of the policy provided a potential defence to any liability in certain defined circumstances. Mr. Flowers has relied heavily upon this clause, asserting that it provides a complete defence to all claims made under these policies. It was principally this defence which he relied on to justify his assertion that there was zero risk. Subsequently, after losses had been claimed, EIC also denied liability on the grounds that it was contrary to public policy to enforce these policies. I discuss these defences below.

The judge's findings of negligence

168 The case against Mr. Flowers was that it was inconceivable that he could responsibly have thought that there was a "zero loss situation," an expression he had himself used in an email sent to the other directors in February 2010. It is alleged that he failed in numerous ways properly to assess risk and make appropriate reserves for the potential liabilities. I propose to consider the judge's findings on negligence by focusing separately on the four ways in which EIC might have avoided losses on these policies: coming off risk either by successful investments or Revenue approval, or successfully relying on one or both of the two defences.

(i) *Chance of successful investments*

169 As to the risk that the relevant profits would not be made, Mr. Flowers' evidence was that he understood the scheme to be a genuine investment scheme rather than a tax avoidance scheme. More specifically, he claimed that he had been told by the promoters of the scheme that the whole of the capital sums, including the loans, were to be invested into the relevant projects. On that premise, he thought it likely that a return of 20% over the five-year period would readily be achieved. He had anticipated a return in the region of 10% per annum, not least because these were sophisticated investors. That would comfortably ensure that the profits generated in the five-year period would exceed the insured amount.

170 The judge categorically rejected this evidence. He did not believe that Mr. Flowers honestly believed that the loan was going to be invested. The judge gave very detailed reasons in support of this finding. It is not necessary to set them all out. Suffice it to say that they included the fact that the Icebreaker documents made it clear to any investor that the loan was

not being invested, that there was nothing in any of the contemporaneous documents indicating that the loan was to be invested and, perhaps most importantly of all, that certain written documents produced by Mr. Flowers himself stated in terms that Icebreaker 2 was a tax scheme. To take just one example, in an email to Butterfield Bank in May 2009, around the time when Icebreaker policies were first issued, Mr. Flowers noted that Icebreaker was looking for a "substantial back-to-back facility for a tax scheme they operate."

171 In the light of the powerful evidence, there is no possible ground for challenging this particular finding of fact by the judge, and none has been advanced.

172 In any event, whether this was his genuine belief or not, the judge held that it was negligent not to read the basic scheme documents properly before issuing the policies. They disclosed that the loan would not be invested. The judge also considered that Mr. Flowers ought to have taken advice as to the nature of the investments and their likely returns. The promoters of Icebreaker gave no indication of likely returns, but the fact that they were marketed as a tax relief scheme would suggest that this was at the very least a likely outcome. In addition, the judge held that it was negligent not to adopt a proper proposal form to elicit from the proposed policy holder whether the whole 100% capital would be invested. All that prospective policy holders had been required to do was to fill out an application form which the judge held was quite inadequate. No representations or warranties had been sought from them. Mr. Flowers said that in relying solely on the application form, he was acting on the advice of Mr. Nigel Feetham (now Mr. Nigel Feetham, K.C.), an expert insurance lawyer who had drafted cl. 11.4. The judge rejected this evidence: this was an important matter, and one would have expected some written documentation evidencing this advice. Mr. Flowers was relying on a vague recollection that this advice had been given, and that was wholly unsatisfactory.

173 Given the judge's finding that Mr. Flowers had appreciated that the loan was not to be invested, it was wholly fanciful for him to believe that the LLP would generate profits sufficient to enable the investors to receive back from the LLP the insured amount. If the full 100% of the contribution, including the loan element, had been invested, there was at least some possibility that the relevant profits might be achieved: a return over five years of 20% might in principle be feasible (although it was still far from certain, and some reserve would surely have been appropriate). However, on an actual investment of 20%, there would have had to be astronomic returns to make good that sum over five years, particularly given the fact that there would be losses in the first year. Mr. Flowers' own expert, Mr. Marcuson, accepted that LLP profits could not be enough to take EIC off risk. Moreover, Mr. Flowers himself said that had he appreciated that the

loan was not part of the moneys invested, he would not have underwritten the risks.

(ii) *Chance of Revenue approval*

174 So far as the possibility of HMRC approval was concerned, Mr. Flowers said that he had relied upon the advice of a leading tax barrister, Mr. Andrew Thornhill, K.C., who had given a number of opinions (not sought by the Enterprise group, but which he had seen) in which Mr. Thornhill apparently expressed the view, with respect to Icebreaker 1, that the scheme should receive Revenue approval. In that event, EIC would be off risk. As the judge pointed out, however, it was known even before any Icebreaker 2 policies were issued that the Revenue was disputing that sideways loss relief was applicable, and therefore counsel's opinion had to be treated with caution. Mr. Flowers said that he understood that Icebreaker 2, which had modified the drafting in Icebreaker 1, had removed some of the problems of the latter, but the judge observed that it was negligent not to obtain advice as to that.

175 In fact, after the policies were issued, there were a number of legal cases involving the tax relief status of both Icebreaker 1 and Icebreaker 2. In early January 2010, the First Tier Tribunal (Tax Chamber) issued a judgment with respect to Icebreaker 1 investments in which it held that the non-recourse loans could not be treated as part of the investment because they had not been expended for trading purposes: *Icebreaker 1 LLP* v. *H.M. Revenue & Customs* (21). In an appeal to the Upper Tribunal, Vos, J. confirmed this ruling.

176 Subsequently, Icebreaker 2 was also the subject of legal proceedings. In *Acornwood* v. *H.M. Revenue & Customs* (1), there were appeals by five LLPs to the First Tier Tribunal ("FTT") on a number of matters, including an appeal against the Revenue's decision not to treat the non-recourse loans as part of the expenditure attracting tax relief. In addition, seven individuals made a joint reference raising a number of questions including whether the investment was a commercial venture, which, as I have said, was a condition precedent to their entitlement to sideways loan relief. The FTT held, consistently with the earlier Icebreaker decision, that the loans could not be treated as part of the investment. The FTT also held that the investment was not, properly analysed, a commercial venture and therefore individual members could not claim sideways loss relief even with respect to such losses as HMRC accepted had been incurred by the LLP.

177 This decision was the subject of two appeals, each of which was heard by Nugee, J. The first was made by the LLPs raising "partnership issues," one of which was an unsuccessful challenge to the ruling of the FTT that the loans were not to be treated as expenses incurred in the trade: the *Acornwood* case, referred to above. The second appeal was made by seven

members raising "members' issues": the *Seven Individuals* case (38), also referred to above. This included an unsuccessful appeal against the FTT finding that the members had not invested in a commercial venture. Nugee, J. held ([2017] UKUT 132 (TCC), at para. 66), that "the correct test is whether the trade is being carried on in a way that commercially-minded people might" and that the FTT was entitled to conclude that it was not, given in particular that their analysis of the relevant investments showed that it was "virtually certain" that they would make a loss (*ibid.*, at paras. 62–63).

178 The significance of these decisions is that even if Mr. Flowers was initially confident, in the light of Mr. Thornhill's opinions, that tax relief would apply, he could not properly adhere to that view in the light of the subsequent case law. He ought, therefore, to have revisited the question of risk and reserves in the light of these developments.

(iii) ***Removing risk by relying on cl. 11.4***

179 In the light of the foregoing, it ought to have been obvious at a relatively early stage that there were considerable risks in underwriting these Icebreaker 2 policies. There was no realistic chance that EIC would be off risk on the basis of investment returns, particularly given that the loan was not invested; and there was from the beginning considerable doubt—which subsequently proved well-founded—whether HMRC or the courts would accept that the schemes attracted sideways loss relief. The only basis on which the directors could in good faith have concluded that there was no risk, and therefore no need to make any reserves for potential liabilities, is if they believed that there was a very strong defence to any liability.

180 It is perhaps not surprising that Mr. Flowers placed considerable weight on cl. 11.4, which excluded liability in certain circumstances. It is as follows:

> "The Insurer shall have no liability to the insured under his Policy where the Insurer reasonably believes, and has reasonable grounds for his belief, that the LLP and the Insured have colluded in an attempt to engineer the failure of the LLP leading to insufficient income being generated causing a claim to arise on this Policy."

181 Mr. Flowers had specifically asked a respected Gibraltar counsel and a specialist in insurance law, Mr. Nigel Feetham, to draft this clause. He said that he understood from Mr. Feetham that the effect of the clause was that if—as turned out to be the case—the Icebreaker 2 schemes did not get Revenue approval, this would be because they were not genuine investments but constituted improper tax avoidance schemes, and cl. 11.4 would then bite to exclude any liability. He also understood that the clause would exclude liability under the policy unless the investor had invested the whole

of the capital contribution, including the loans. He was not able to point to any communication with Mr. Feetham emphasizing that liability should be excluded in these circumstances, but he believed that Mr. Feetham had appreciated the need to do this, and he assumed that cl. 11.4 had been framed to have that effect.

182 However, the judge did not accept that Mr. Flowers could reasonably have believed that the clause had the effect he claimed. Mr. Feetham did not give evidence about the nature of his instructions and the judge found that there were no proper instructions given to Mr. Feetham. Email communications between the two parties suggested that the clause was drafted on the basis of relatively limited information. Moreover, the judge noted that the clause made no reference whatsoever to the fact that the policy would only apply if the whole capital contribution, including the loan, was invested. Nor did it refer to the need for the policy holder to be a "genuine investor." The judge held that if it had been considered so important to exclude these categories, he would have expected very clear instructions to that effect. Mr. Feetham would have drafted a very different clause if its purpose had been as Mr. Flowers claimed.

(iv) ***Removing the risk by relying on public policy***

183 Finally, Mr. Flowers also relied upon the fact that after the *Acornwood* case (1), which held that the scheme did not secure the relevant tax relief, he had taken further legal advice from Ozon Solicitors and Mr. Dutton, K.C. about how to respond to claims made under the Icebreaker policies. He alleged that the advice was that EIC had valid defences to the claims. Mr. Dutton drafted an appropriate letter ("the Dutton letter") setting out the company's position, and this was sent to policy holders explaining why they had no claim. The letter put forward defences of misrepresentation—no longer relied upon—and the two defences of cl. 11.4 and public policy. No policy holder had successfully made a claim until the liquidator took the view that EIC was legally obliged to meet the claims. He asserts that the total potential liability is some £31.6m.

184 The judge held that it was clear from a note of a meeting that Mr. Flowers had given false information about the schemes. For example, Mr. Flowers had stated that he thought that this was an investment scheme and that all the capital, including the loan, had been invested, and that he only learnt that this was not so from the *Acornwood* decision. Moreover, Mr. Dutton had not provided any formal advice, although Mr. Flowers said that this was because Mr. Dutton had said that there was no point in so doing.

185 Mr. Flowers' reliance on these two defences is an extremely important feature of the case. If, as Mr. Flowers claimed, he had acted on "extensive and high-level legal advice" which justified his belief that there were no risks involved in writing these policies, he would not be negligent

in failing to make any reserves with respect to them. However, the judge's conclusion that the advice of both lawyers was "limited and based on inadequate instructions" undermined the value of the advice and its reliability.

The judge's summary of conclusions

186 Looking at the matter overall, the judge held that Mr. Flowers was negligent in a number of ways in relation to the issues of risk and reserves. The judge summarized his reasons as follows (2034/GSC/008, at para. 841):

> "This is business which should never have been written, or only written carrying appropriate reserves although this would not have been possible. Mr. Flowers should have made adequate inquiries about all the businesses that the LLPs were investing in, he should have obtained independent legal and tax advice about the changes to Icebreaker 2, he should have provided clear instructions on the exclusion clause to be included in the policies, he should have ensured that policyholders signed an appropriately drafted proposal form, and he should have considered reserving and reinsurance protection carefully and ideally with the assistance of actuaries. Further, the legal advice provided following the 2014 Acornwood decision was based on inaccurate instructions. For all these reasons, Mr. Flowers as an experienced insurance professional fell below the standard expected of a reasonably competent director with his attributes, and as a result has caused EIC loss . . ."

Grounds of appeal

187 The principal ground of appeal in effect seeks to sidestep the judge's findings of negligence completely. Mr. Pennington-Benton, arguing this point on behalf of Mr. Flowers, has submitted that, properly analysed, both cl. 11.4 and the defence of public policy defeat any claims under the policy and that the judge ought to have so concluded. He does not allege, as Mr. Flowers had done, that they provide a defence simply because the loan element was not invested. However, he does place weight on the fact that these insurance policies were never intended to cover blatant tax avoidance schemes of this nature, and that it is both contrary to public policy and to the terms of cl. 11.4 that they should do so. If he is right, and either of these defences is applicable on the facts, then EIC will not be liable to meet claims under the policies. It follows, therefore, that EIC will have suffered no loss arising directly from the issuing of these policies. Since there is no claim in the tort of negligence unless loss can be proved, EIC will in turn have no claim against Mr. Flowers, irrespective of how irresponsible or careless he may have been.

188 A second ground of appeal, which only arises if the principal ground fails, essentially repeats the contention advanced below that Mr. Flowers had reasonably relied upon legal advice and therefore could not be said to be negligent. This was not pursued with any real vigour. In my view, it is unsustainable. The judge found that legal advice had been given on the basis of inadequate instructions and without the lawyers involved being fully cognizant of the true nature of the arrangements. He was entitled to hold that in the circumstances Mr. Flowers could not hide behind that advice. Furthermore, with respect to the Dutton letter, it is not clear whether the lawyers were simply saying that the defences there relied upon were properly arguable, or whether they were positively optimistic about their chances of success.

Icebreaker defences: are they applicable?

189 Before I turn to the two defences, I need to point out a potential qualification to Mr. Pennington-Benton's assertion that if the policy holders have no claims, there is no loss to EIC and therefore no tort of negligence has been committed. As I have explained (at para. 160 above) the claim for damages is not limited to loss flowing from the obligation to meet the liabilities of policy holders. An alternative submission relates to the alleged damage resulting from the failure to calculate the appropriate reserves in the annual accounts from 2010 onwards which, had they been assessed with the full risks properly appreciated, may have resulted in EIC entering into insolvency much earlier than it did.

190 It might be said that even if in fact there is a defence to these policies, it was nonetheless wrong not to set any reserve at all because the issue was never clear and there must at least have been real doubt about that. If that is right, then logically it might be possible to show that it was negligent to set no reserve at all, notwithstanding that with hindsight it can be seen that there was no liability to the policy holders. It could also be the case that had the appropriate reserves been determined, and had the company not been in a position to meet them, it would have been apparent that the company was insolvent. However, even if that is right in theory, if either of these defences does defeat the claims, this must have a bearing on the calculation of the reserves fixed by Dr. Brown because he assumed (with a minor qualification) that the defences would not be available. On the premise that there was at least a real likelihood that there was a defence to these liabilities, a significantly lower level of reserves than those set by Dr. Brown would have been appropriate and this would make it less likely that EIC would have been unable to meet those liabilities. If there was sufficient capital to meet the reserves, EIC would not then be insolvent.

191 Mr. Pennington-Benton's first submission on this aspect of the case was that the judge did not actually decide whether these defences applied

or not. The judge simply noted that the liquidator had taken the view, after receiving legal advice, that they were not applicable and that EIC should treat their claims as debts in the liquidation. The liquidator began paying out on these policies even though, until that time, EIC had successfully resisted making any payments based on the Dutton letter. Mr. Pennington-Benton said that the judge appeared to be accepting the liquidator's view as determinative of liability. Mr. Pennington-Benton submitted, and Mr. Jones did not dispute this, that if there is potential liability for negligence, there must be loss and it is for the court to determine whether that is the case. It would be an abnegation of responsibility for the court to say that if the liquidator takes the reasonable view that there is loss, this should bind the court.

192 I think if one focuses on the passage in the judgment where the judge addresses the two defences (2034/GSC/008, at paras. 832–840), there is force in the appellant's submission. The judge said, with respect to both defences, that EIC had advanced detailed arguments why they were not applicable, but he did not in terms confirm that he accepted those arguments. However, I am inclined to accept the submission of Mr. Jones that when dealing with Mr. Flowers' submissions on cl. 11.4, the judge had already, in para. 822, given reasons, albeit relatively briefly, why he did not accept that it provided a defence. However, there is no equivalent finding by the judge that he also rejected the public policy defence. Mr. Jones contended that on a fair reading of the relevant passage where the issue of loss is considered, the judge had impliedly accepted the liquidator's arguments as to why there was no such defence. I am not convinced that he did, not least because in those paragraphs the judge seems to be focusing on whether the liquidator was entitled to conclude, contrary to the position EIC had adopted hitherto, that EIC was legally bound to pay out under the policy. The judge noted that Mr. Flowers or any other aggrieved person could challenge the decision to admit these claims, but that hardly seems relevant to Mr. Flowers' liability to EIC.

193 However, it is not necessary to decide whether the judge did reach a firm view on these defences. Counsel have accepted that if the judge did not decide them, or either of them, he ought to have done and we should now do so. If, on the other hand, he did decide them, or either of them, we must consider whether he was right. The latter possibility required an amendment to the notice of appeal, which we permitted, because the appellant had not advanced as a ground of appeal that if the judge had, contrary to his primary submission, determined that these defences did not apply, he wished to appeal the judge's conclusions. We also agreed that we would receive written submissions on the applicability or otherwise of these defences since the skeletons did not fully address that question. Counsel took full advantage of that opportunity.

Construction of cl. 11.4

194 For convenience, I repeat the clause here:

> "The Insurer shall have no liability to the insured under his Policy where the Insurer reasonably believes, and has reasonable grounds for his belief, that the LLP and the Insured have colluded in an attempt to engineer the failure of the LLP leading to insufficient income being generated causing a claim to arise on this Policy."

We received extremely detailed written submissions on the proper construction of this clause, but I propose to deal with it relatively briefly.

195 I make the following preliminary points. First, it is alleged that the clause provides a defence to a claim from any Icebreaker 2 policy holder. The facts which exclude liability are therefore systemic to the way in which the scheme operates. It follows that the act of collusion referred to in the clause must be inherent in how the scheme works.

196 Second, as Mr. Flowers accepted in cross-examination, an investor could not affect the way the scheme operated. If an investor chose to join the scheme, it was on the terms proposed by the promoters of the scheme: there was no room for individual negotiation over the structure of the scheme itself, nor over where the funds will be invested. There might in theory be an opportunity, once the project has been set up, to seek to make it less successful than it might otherwise be, but that would not be systemic to the scheme itself. Alternatively, an investor could try in some other way to cause loss to the LLPs in a manner unrelated to his investment. But such acts would be the acts of rogue individuals; they would not trigger a blanket exclusion for all members who were policy holders. Moreover, there is no reliance by Mr. Flowers on any conduct of that nature, and no evidence of it either.

197 Third, the notion of collusion implies an air of conspiracy involving concealment of certain facts or objectives, or deliberate deception.

198 Mr. Pennington-Benton contends that the collusion in this case is in substance the false representation that all the features of this scheme constitute a genuine commercial transaction entered into for profit, when in fact the true aim was to make a loss. In the written submissions the argument was summarized thus:

> "The appellant's case is that the various acts [essentially the different elements in the operation of the scheme], presented in the way they were (which is important), amounted to a ruse: a presentation to the outside world generally, and to HMRC and EIC in particular, that the members were engaging in a genuine business trade seeking to make profits but which in reality comprised a deliberate effort to make the

LLP fail, leading to insufficient Member Proceeds and, first a claim for relief, and, failing that, a claim on the policy."

199 The most important element in the scheme on which counsel relied was the representation that the whole capital sum of £100 was an expense of the trade when in fact £80 was the loan which was never used to drive the trade forward at all.

200 At the core of this submission, therefore, is an allegation of misrepresentation: the members and the LLP have together colluded to present the scheme as something other than it is. It has not, however, been alleged in these proceedings that any misrepresentations were made to EIC, nor that the policy could be avoided for that reason. That is so even though the Dutton letter did rely on misrepresentation as one of the grounds for refusing to meet the claims. Furthermore, to the extent that the allegation is that the documents presented to the Revenue deliberately misrepresented the true facts, that would amount to tax evasion, not simply tax avoidance. That is not the basis on which the case was defended below. Moreover, if this was a case of tax evasion, it would not be necessary to rely on cl. 11.4. The scheme would be unlawful, and it is inconceivable that a court would be willing to allow the insurance contract to be enforced against EIC.

201 In the *Acornwood* decision (1) at first instance, the FTT said in terms ([2014] UK FTT 416 (TC), at para. 9) with relation to the Icebreaker 2 scheme, that "It is not suggested that any part of the arrangements was a sham, or that the claimed payments were not made."

202 The principal argument advanced by the Revenue before the FTT was simply, as the FTT put it (*ibid.*, at para. 6), "that the schemes did not work." Indeed, the FTT itself referred to this argument as "the ineffective argument." It is also relevant to note that the FTT decision with respect to Icebreaker 1 did suggest that some of the documentation in that case "bordered on being false and deceptive" (*ibid.*, at para. 162), although it was not necessary for the FTT to determine that question. The Revenue will have been alive to the possibility of potentially misleading documents in Icebreaker 2, but even so it made no allegations that they were misleading, possibly because of changes in the wording of the documents between Icebreaker 1 and Icebreaker 2.

203 In my view, there is no basis for Mr. Pennington-Benton's submission that the documents themselves were not transparent, in the sense that they failed to lay out accurately the various elements of the scheme. There was never any attempt to conceal what counsel particularly relies upon, namely the fact that the loan was not going to be put at risk. It was a key feature of the Icebreaker schemes. Also, the judge was satisfied that Mr. Flowers always appreciated this, notwithstanding his assertions to the contrary.

204 Mr. Pennington-Benton's argument focuses almost exclusively on the submissions made to the courts by counsel when seeking to persuade the courts that the scheme arrangements satisfied the requirements for sideways loan relief. He refers to various observations of the courts in the *Acornwood* litigation, when rejecting the LLPs' legal arguments. For example, with respect to the complex loan arrangements, the court said that the expenses were "artificially inflated," that they served "no commercial but only a tax purpose," and that they gave "no commercial advantage."

205 It is true that both the FTT and Nugee, J. rejected the arguments of the LLPs and their members in categorical and robust terms and were sometimes quite disparaging about them. But this does not assist counsel's case. Nugee, J. had in the *Acornwood* case accepted a distinction, suggested by counsel, between sham and mislabelling ([2016] UKUT 361 (TCC), at para. 59):

> "I accept that the two doctrines, of sham and mislabelling, are different doctrines; and I also accept that in this case HMRC's acceptance that the contractual documents entered into by the parties were not shams or pretences does not preclude them from contending that a statement in a contract that £x is paid in consideration of Y is not reflective of what the consideration truly was for which £x was paid."

206 In other words, the court is entitled to draw its own inferences about the true nature and purpose of the schemes and their various elements in the light of the documents and the evidence they have heard. They can, and do, frequently reject the LLPs' attempts to put a very different gloss on their nature and purposes. But in putting forward their own submissions, the LLPs are not acting dishonestly, or concealing relevant facts from the courts or the Revenue. They are simply seeking to persuade the court that, properly understood, the schemes fall within the scope of the relevant statute conferring the tax benefit. The rhetorical exaggerations of an optimistic counsel are not dishonest statements or representations.

207 Moreover, the representations to HMRC and to the courts were not representations to EIC and EIC did not enter into the Icebreaker policies on the basis of them. EIC could—and the judge held that they should—have taken its own advice about the nature of these schemes and their likely commercial success.

208 Furthermore, even if one could find some collusion between the members and the LLP in allowing counsel to make these submissions, their purpose could not conceivably be described as an attempt to engineer the failure of the LLP. On the contrary, counsel were relying on the failure of the LLPs to make a profit for the purpose of establishing the losses which underpinned the basis of any tax relief. That was in EIC's interests since,

had the arguments been successful, they would have taken the policies off risk.

209 I do not see how, merely by investing in the scheme on the terms offered, an investor can be said to be colluding with the LLP at all. Passive involvement does not amount to collusion. That concept implies active steps to achieve a particular purpose. It is not satisfied by simply signing up to a scheme which has been predetermined by one party. Nor could the members be described as seeking to *engineer* the failure of the partnership. I would accept that many investors will have joined the scheme knowing that in all probability it would fail, but that does not mean that they were attempting to engineer its failure. The member was not engineering anything, whether by collusion or otherwise. He neither selected the project for a particular scheme (although he might opt into a particular LLP because he is attracted by the project) nor was he involved in its exploitation.

210 I appreciate that it is not necessary under the exemption for there actually to be an act of collusion for the forbidden purpose. It is enough that EIC has reasonable grounds to believe that to be the case. However, I do not accept that there are any reasonable grounds for believing that view; it is not a reasonable inference from the facts that there has been any relevant collusion, nor any joint attempt by each and every member to engineer the failure of the LLP.

211 There is a further fundamental problem with Mr. Pennington-Benton's submission. On his analysis the collusion arose when the LLP member signed up to the scheme and thereby "bought into the plan." Yet all the elements of the scheme were in plain sight; they were not concealed from EIC. If cl. 11.4 has the meaning for which counsel contends, the policyholder is never being protected against any risks whatsoever: the exclusion clause will bite immediately the policy comes into effect and EIC agrees to underwrite the risks. The company will have designed a bespoke policy, framed to deal with these specific investments, which on its terms can never come into effect.

212 It is a well-established principle of insurance law that an exclusion clause in such a contract "must be construed in a manner which is consistent with and not repugnant to the purpose of the insurance contract" (*per* Lord Hodge in *Impact Funding Solutions Ltd.* v. *Barrington Support Services Ltd.* (22) ([2016] UKSC 57, at para. 7)). To treat the very act of entering into the scheme as an act of collusion of a kind which falls within the scope of the exclusion clause would not merely be repugnant to the purpose of the policy, it would negate its purpose entirely. No court would adopt such a construction of the clause unless compelled to do so.

Public policy

213 The submission is that it is contrary to public policy for the courts to give effect to this particular insurance policy. It is alleged that it would provide an incentive for parties to engage in aggressive and artificial tax avoidance schemes.

214 In the context of advancing his arguments on this aspect of the case, Mr. Pennington-Benton relied upon the underlying scheme being immoral. He also raised the possibility that it might be dishonest, amounting to tax evasion and not merely an attempt at tax avoidance. He suggested that the line between lawful conduct and the dishonest reliance on false documents "may have been crossed." As I have said, there is no basis for that assertion, and it has never been a case which the LLPs or their members have had to meet. In any event, a court cannot treat as void an insurance contract simply because the underlying transaction on which it is based "might" be unlawful. I therefore focus only on Mr. Pennington-Benton's alternative submission, that the underlying tax avoidance scheme was immoral, at least in the sense of a social evil which the law should be unwilling to enforce.

215 The starting point when testing the law's approach to tax avoidance schemes is the following well-known observation of Lord Tomlin in *Inland Revenue Commrs.* v. *Duke of Westminster* (23) ([1936] A.C. at 19):

> "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax."

216 Observations to similar effect were made by Lord Hoffmann in *Norglen Ltd.* v. *Reeds Rains Prudential Ltd.* (27), and are also, in my judgment, highly material in dealing with this aspect of the argument. This was a decision about the validity of an assignment of a cause of action to a director of a company where the purpose was to enable the director to obtain legal aid when the company could not. Lord Hoffmann said this ([1999] 2 A.C. at 13G):

> "If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like stratagem or device. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work (*Inland Revenue Commissioners v. Duke of Westminster* [1936] AC 1) or they do not (*Furniss v. Dawson* [1984]

> A.C. 484.) If they do not work, the reason, as my noble and learned friend Lord Steyn pointed out in *Inland Revenue Commissioners v. McGuckian* [1997] 1 WLR 991, 1000, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence."

217 I construe this as meaning that one should not start with an abstract view that the scheme under scrutiny is immoral or unacceptable because it employs artificial devices or stratagems designed to bring the scheme within the terms of the statute conferring the benefit. The only relevant question is whether it succeeds in its objective, which it will do if it falls within the scope of the relevant provisions. Whether the scheme is considered objectionable or otherwise immoral is beside the point: there is no "penumbral spirit" which one can add as a gloss to the statute to defeat what would otherwise be a valid claim to the benefit, because the scheme is thought objectionable.

218 It is true that both the courts and Parliament have adopted an increasingly hostile approach to what are perceived to be artificial tax avoidance schemes. The courts, following the speech of Lord Wilberforce in the seminal case of *W.T. Ramsay Ltd.* v. *Inland Revenue Commrs.* (47), have adopted a much more stringent interpretation of tax statutes, although subsequent cases have emphasized that this was because a practice of giving an unduly strained and artificial construction to tax statutes had been adopted in tax cases, at odds with the general construction principles adopted in other spheres of the law. In *Barclays Mercantile Business Finance Ltd.* v. *Mawson (H.M. Insp. of Taxes)* (8) in a decision of the House of Lords to which Lords Nicholls, Steyn, Hoffmann, Hope, and Walker all contributed, the court said this ([2004] UKHL 51, at paras. 28–29):

> "28. As Lord Steyn explained in *Inland Revenue Commissioners v McGuckian* [1997] 1 WLR 991, 999, the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until the *Ramsay* case, however, revenue statutes were 'remarkably resistant to the new non-formalist methods of interpretation'. The particular vice of formalism in this area of the law was the insistence of the courts on treating every transaction which had an individual legal identity (such as a payment of money, transfer of property, creation of a debt, etc) as having its own separate tax consequences, whatever might be the terms of the statute. As Lord Steyn said, it was:

> 'those two features—literal interpretation of tax statutes and the formalistic insistence on examining steps in a composite scheme separately—[which] allowed tax avoidance schemes to flourish.'

29. The *Ramsay* case [1982] AC 300 liberated the construction of revenue statutes from being both literal and blinkered."

219 This development made it much more difficult to adopt successful tax avoidance schemes than had been the case, but that was not because the fundamental principle enunciated in the *Duke of Westminster* case (23) had been questioned; it was because the principles of analysis determining whether a scheme falls within the statutory provision have changed.

220 Parliament has also taken a more active role in seeking to outlaw unacceptable schemes of this nature. In the Finance Act 2013, it introduced the General Anti-Avoidance Rules ("GAAR") which are designed to counter abusive tax schemes. There are also a number of other more specific anti-avoidance provisions. Indeed, one relates very directly to the Icebreaker type of arrangement. Section 74ZA of the Income and Corporation Taxes Act 1988, introduced by the Finance Act 2010, is an example of what Nugee, J., in the *Seven Individuals* case (38), described ([2017] UKUT 132 (TCC), at para. 23) as a "targeted anti-avoidance rule." The section took effect in relation to a loss arising in connection with arrangements entered into on or after October 21st, 2009. In essence, it provides that the sideways loss relief will not apply if the loss results from relevant tax avoidance arrangements, and these were defined to include a scheme where "the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief . . ." In *Seven Individuals* this was a reason for denying the tax benefit to one of the individuals. It would no doubt have caught many others had their investments been made after the relevant date.

221 An important feature of these legislative provisions is that they do not impact on the underlying agreements: they are not rendered unenforceable. The only effect is that when the provisions bite, the scheme fails to attract the tax benefit it is designed to achieve.

222 These developments are consistent with the notion that the law is setting its face against schemes of this nature. Some further evidence for this, strongly relied upon by Mr. Pennington-Benton, is provided by some observations of Lord Walker in *Pitt* v. *Holt* (30). He said this ([2013] UKSC 26, at para. 135):

> "In *Futter* this court declined to permit the appellants to raise for the first time the issue of mistake, primarily because there was no sufficient evidential basis for considering that issue for the first time on a second appeal. *Gibbon v Mitchell* received a passing mention in the judgment of Norris J [2010] STC 982, para 20, but only for the

purpose of rejecting the Revenue's argument that the distinction between 'effect' and 'consequences' was relevant to the *Hastings-Bass* rule. Had mistake been raised in *Futter* there would have been an issue of some importance as to whether the Court should assist in extricating claimants from a tax-avoidance scheme which had gone wrong. The scheme adopted by Mr Futter was by no means at the extreme of artificiality (compare for instance, that in *Abacus Trust Co (Isle of Man) v NSPCC* [2001] STC 1344) but it was hardly an exercise in good citizenship. In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy. Since the seminal decision of the House of Lords in *WT Ramsay Ltd v IRC* [1982] AC 300 there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures. But it is unnecessary to consider that further on these appeals."

223 It is important to put these comments in context. Lord Walker had earlier in the judgment rejected a submission from HMRC that no relief from the duty to pay tax can ever be granted, even in equity, where a mistake relates exclusively to the interpretation of the relevant tax rules: (*ibid.*, at paras. 129–132). However, the effect of a mistake is that it renders a transaction voidable, not void. It was in that context that Lord Walker envisaged the possibility that it may be appropriate in certain cases to refuse relief because of the artificial tax avoidance nature of the transaction. That is a very far cry from accepting that all tax avoidance schemes should be outlawed.

224 Even if the common law might still be willing to expand the categories of contracts considered to be contrary to public policy, which was a matter of dispute before us, I have no doubt that it should not do so in the context of allegedly abusive tax schemes. This is a highly complex and sensitive area. It is to be noted that the GAAR were adopted after a report and extensive consultation as to the full implications of rules of this nature. Parliament has to some extent regulated the area, but it has not rendered unlawful tax avoidance schemes, merely rendered them ineffective. I do not think it would be appropriate for the common law to go further. It is one thing for the courts to ensure that proper principles of statutory construction are adopted; as with *W.T. Ramsay* (47) and subsequent cases, that is classic common law territory. It may even be appropriate for a court to refuse to exercise a discretion in equity, when it is fully cognizant of the facts of the case and can take a considered view of the justice or otherwise of refusing such relief. But the court has no right

to take a step which would involve departing both from the clear authority of the *Duke of Westminster* case (23), and the observations of Lord Hoffmann in the *Norglen* case (27). In my judgment, the court would also be at risk of creating both unfairness and uncertainty if it were to apply public policy on a case-by-case basis. Mr. Poole accepts that there are many tax avoidance schemes which are perfectly legitimate and acceptable. It would be very difficult, in my view, to determine where to draw the line between acceptable and abusive schemes without a consideration of wider implications than are likely to be identified in any individual case.

A contrary approach

225 I briefly touch upon some recent judicial developments which relate directly to these EIC policies, and which Mr. Flowers has heavily relied upon in this context. One of the policy holders whose claim had been rejected by EIC, Mr. Kennedy, made an application to the Financial Ombudsman challenging EIC's decision not to meet his claim. The Ombudsman rejected the application. He considered that it was reasonable for EIC to have refused the claim principally on the basis that "all concerned knew perfectly well that the capital contribution was a pretence, given that the loan was not invested."

226 Mr. Kennedy then made an application to the Financial Services Compensation Scheme ("FSCS") in the UK, which provides a compensation scheme to compensate those who, *inter alia*, have suffered loss resulting from the insolvency of an insurance provider. This application too was rejected on grounds which appear to have assumed that the contract, being related to tax avoidance, was illegal, thereby blurring the distinction between tax avoidance and tax evasion. Mr. Kennedy sought judicial review of that decision, arguing that it was irrational. It was refused on paper at the leave stage by Sir Ross Cranston, and Lang, J. rejected the application at the oral hearing: *R. (Kennedy)* v. *Financial Services Compensation Scheme Ltd.* (32). She held that the case did not come close to establishing an arguable case of irrationality. She reasoned that ([2021] EWHC 3039 (Admin), at para. 10): "The defendant was entitled to take the view that contracts which seek to avoid tax legislation can engage the illegality doctrine."

227 A further application for permission to appeal to the Court of Appeal was similarly unsuccessful. Coulson, L.J. held that the decision of Lang, J. was "unarguably right," and that the challenge to it was "absurd."

228 On the premise that the underlying tax avoidance scheme was illegal, it was plainly open to the FSCS not to make a payment. EIC would not have been obliged to do so, in line with the decision of the Supreme Court in *Patel* v. *Mirza* (29), and so there was no loss to compensate. It is not surprising either, on that premise, that the courts gave short shrift to the attempt to review that decision.

229 Since the decision of Coulson, L.J. was merely a permission application determined by a single judge with no full argument, it has no force as a precedent. Furthermore, if, as seems probable, the FSCS was acting on a mistaken apprehension about the legal consequences of tax avoidance schemes, the analysis of the subsequent courts was flawed. But whether that is so or not, and whatever the position in public law, in my view the authorities to which I have referred are wholly inconsistent with the notion that the common law doctrine of public policy can invalidate either a contract's underlying tax avoidance arrangements, or insurance policies underwriting the risk of loss arising out of such arrangements.

230 For these reasons, in my judgment Mr. Flowers' challenge to the finding of negligence with respect to the Icebreaker policies fails.

Insolvency: the creditor duty and ratification

The law

231 A director owes fiduciary duties to the company. In most circumstances, at least where a company is solvent, the duty is to advance the success of the company for the benefit of its shareholders, although that does not wholly exclude consideration of wider interests, such as those of employees and suppliers. In the UK, this is all set out in s.172 of the Companies Act 2006. There is no statutory equivalent in Gibraltar, but s.172 itself reflects the common law developments which underpin the law in Gibraltar.

232 However, it had become increasingly recognized, notably in the decision of the Court of Appeal in *West Mercia Safetywear Ltd.* v. *Dodd* (49), that there will be circumstances, and insolvency is the classic example, where actions taken in the interests of the company must also involve consideration of the interests of the creditors. There will be what is conventionally termed a "creditor duty."

233 The authoritative case which finally affirmed that this duty will sometimes be engaged is the decision of the Supreme Court in *Sequana* (7). This appeal was decided after the judge had heard the case but before he issued his judgment. The parties made written submission about the decision, and he was able to take it into account in his judgment.

234 There are four judgments in the case, given by Lord Reed, Lord Briggs (with whose judgment Lord Kitchin agreed), Lord Hodge and Lady Arden. The first three judgments are essentially in agreement on virtually all issues, although there are some minor variations in the precise formulation of the principles. They identify the following four features with respect to the creditor duty.

235 First, properly analysed, the creditor duty is simply an aspect of the fiduciary duty of directors to act in the best interests of the company. Lord Reed summarized the position as follows ([2022] UKSC 25, at para. 77):

> "It is important to understand that the rule in *West Mercia* does not create any new duty: it merely adjusts the long-established fiduciary duty to act in good faith in the interests of the company. Where the rule applies, the way in which the company's interests are understood, for the purposes of that duty, is extended so as to encompass the interests of the general body of creditors as well as the interests of the general body of shareholders. That reflects a recognition that the traditional identification of the interests of the company with those of its shareholders, although satisfactory when the company is financially stable, needs to be widened when insolvency is imminent. The interests of the creditors as a whole should then also be taken into account and given appropriate weight, as explained in para 81 below. If insolvent liquidation or administration is unavoidable, the interests of the shareholders drop out of the picture, and the company's interests can be treated as equivalent to those of the creditors alone."

236 Second, as Lord Reed noted, the duty arises when insolvency is imminent. This formulation was modified in the judgment of Lord Briggs as follows (*ibid.*, at para. 203):

> "I would prefer a formulation in which either imminent insolvency (ie an insolvency which directors know or ought to know is just round the corner and going to happen) or the probability of an insolvent liquidation (or administration) about which the directors know or ought to know, are sufficient triggers for the engagement of the creditor duty."

Lords Reed and Hodge broadly agreed with this approach as to the point in time when the duty arises.

237 However, it is to be noted that this formulation does not make the duty contingent solely on the point at which the company is insolvent or facing imminent insolvency; it also makes it conditional upon the knowledge of the directors. They must either know, or ought to know, that the company is actually or imminently insolvent. Lord Hodge, in a separate judgment, agreed that knowledge or constructive knowledge was a necessary condition of the duty arising.

238 However, Lord Reed and Lady Arden did not think it appropriate to determine the issue of knowledge at all. The point was not directly in issue, it had not been argued before them, and they preferred not to engage with it. An alternative approach could be to make the circumstances triggering the duty independent of the knowledge of the directors but to relieve them from liability if they have acted honestly and reasonably. It was accepted

by counsel for EIC, however, that whatever the merits of the contending arguments, it would be unrealistic for us to do anything other than to follow the majority view, notwithstanding that it was not strictly part of the ratio of the case.

239 Third, again as Lord Reed noted in the extract quoted above—and Lord Briggs also analysed this issue in some detail (*ibid.*, at paras. 163–178)—the duty owed to the creditors is not necessarily the paramount or exclusive duty even when the company is insolvent but not yet in liquidation. Acting in the best interests of the company may involve a balancing of shareholder and creditor interests even when a company is insolvent. It is a highly fact-sensitive inquiry to determine how the conflicting interests should be resolved in the best interests of the company.

240 Fourth, once the creditor duty is engaged, it can no longer be justified to allow the general body of shareholders to authorize or ratify breaches of duty which are no longer owed exclusively to them as beneficiaries. This is so whether the ratification is by a formal decision of the members or by informal unanimous agreement in accordance with the *Duomatic* principle. As Lord Reed put it in *Sequana* (*ibid.*, at para. 91):

> "As has been explained at paras 40–45, the law governing shareholder authorisation and ratification has developed in recent times in parallel with the law governing the directors' fiduciary duty, sometimes in the same cases. As the law was stated in *Ciban Management Corpn v Citco (BVI) Ltd* [2021] AC 122, para 40, the shareholders cannot authorise or ratify a transaction which would jeopardise the company's solvency or cause loss to its creditors. That principle should ensure that, where the directors are under a duty to act in good faith in the interests of the creditors, the shareholders cannot authorise or ratify a transaction which is in breach of that duty."

241 Or as Lord Briggs more pithily expressed it (*ibid.*, at para. 196):

> "[T]he trigger for the engagement of the creditor duty must sensibly coincide with the moment when the ratification principle ceases to apply . . ."

The significance of the creditor duty in this case

242 The liquidator alleged that EIC had in fact been insolvent, or insolvency was at least imminent, at all times from June 30th, 2010, some six years before the company went into liquidation. He asserted that the creditor duty had been engaged. This was potentially relevant to the arguments advanced in this case for two reasons. First, one of the grounds identified in the re-amended particulars of claim (at para. 69.9) as to why the MSA and PIE payments were unlawful, at least with respect to payments made after the June 30th, 2010, was that they were made in

breach of the creditor duty. (In fact, it is alleged that from that time the "paramount duty" was owed to the creditors, which arguably was not the case, at least for all that period. But it is enough for the purposes of this argument that consideration should have been given to the interests of the creditors. The failure to do so would of itself constitute a breach of fiduciary duty, whether their interests were paramount or not.)

243 The second reason why the creditor duty is important is that if it was applicable, it would constitute an additional reason why ratification of the MSA and PIE payments would not have been possible.

244 If I am correct in upholding the finding of the judge below that the MSA and PIE payments were unlawfully paid in breach of fiduciary duty, it will not strictly matter whether this submission of the liquidator is right or not. Breach of the creditor duty will then just provide an additional ground why some of the payments, namely those made after June 30th, 2010, would have been made in breach of that duty. (Indeed, if the creditors' interests had to be considered to the exclusion of the shareholders' interests, it would be the only ground on which the breach of fiduciary duty would be established since no duty to shareholders would be owed.) Similarly, on the assumption that my analysis of ratification is correct, this argument, if right, simply provides a further reason why ratification is not possible on the facts of this case. However, I have engaged with these issues both because we heard extensive argument about them, and because they could be important if my earlier analysis is incorrect.

The judgment below

245 I turn to consider the relevant law and in particular the two conditions which need to be satisfied before the creditor duty arises. First, the company must in fact be insolvent (a term which in this context I will use to include imminent insolvency). Second, the defendant must have actual or constructive knowledge—either he knows or ought to know—that the company is insolvent. I will consider each condition separately.

The first condition: was EIC insolvent?

246 The judge dealt with the law in this area in some detail. I broadly draw on the authorities to which he referred, but with a slight difference of emphasis.

247 The statutory definition of insolvency in Gibraltar changed slightly in the period covered by the facts of this case. The relevant provision until November 1st, 2014 was s.221(c) of the Companies Act 1930, and it was replaced from that date by s.10(1)(b) of the Insolvency Act 2011. The 1930 Act definition was similar to the definition in the then applicable English law, s.168 of the Companies Act 1929, and the Insolvency Act 2011 definition was similar to the definition in s.123 of the English Insolvency

Act 1986. In *BNY Corporate Trustee Servs. Ltd.* v. *Eurosail-UK 2007-3BL plc* (6), Lord Walker, giving the lead judgment in the Supreme Court (with which Lords Hope, Mance, Sumption and Carnwath agreed), observed that the definition in the 1986 Act, although worded differently from earlier statutory definitions, was not intended to change the essential nature of the test for insolvency as it had existed prior to that Act. That must apply equally in Gibraltar, therefore. Accordingly, potential complications arising from two different provisions applying at different stages of EIC's history do not arise.

248 Section 10(1) of the Insolvency Act 2011 provides as follows:

> "A company—
>
> . . .
>
> (b) is insolvent if—
>
> (i) it is unable to pay its debts as they fall due; or
>
> (ii) the value of its liabilities exceeds its assets."

249 There are, therefore, two applicable tests which are known as the "cash-flow" test and the "balance sheet" test (sometimes also referred to as the "commercial insolvency" test). In *Bucci* v. *Casa Estates (UK) Ltd.* (9) ([2014] EWCA Civ 383, at para. 29), Lewison, L.J. observed that "the two tests feature as part of a single exercise, namely to determine whether a company is unable to pay its debts." He also summarized the relationship between the two tests as explained by Lord Walker in *Eurosail* (6) (*ibid.*, at para. 27):

> "In my judgment the following points emerge from the decision of the Supreme Court in *Eurosail* (and in particular the judgment of Lord Walker):
>
> i) The tests of insolvency in section 123 (1) (e) and 123 (2) were not intended to make a significant change in the law as it existed before the Insolvency Act 1986: para [37].
>
> ii) The cash-flow test looks to the future as well as to the present: para [25]. The future in question is the reasonably near future; and what is the reasonably near future will depend on all the circumstances, especially the nature of the company's business: para [37]. The test is flexible and fact-sensitive: para [34].
>
> iii) The cash-flow test and the balance sheet test stand side by side: para [35]. The balance sheet test, especially when applied to contingent and prospective liabilities is not a mechanical test: para [30]. The express reference to assets and liabilities is a practical recognition that once the court has to move beyond the reasonably near future any attempt to apply a cash-flow test will

become completely speculative and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) becomes the only sensible test: para [37].

iv) But it is very far from an exact test: para [37]. Whether the balance sheet test is satisfied depends on the available evidence as to the circumstances of the particular case: para [38]. It requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to meet those liabilities. If so, it will be deemed insolvent even though it is currently able to pay its debts as they fall due: para [42]."

250 It was common ground between the experts in this case, and accepted by the judge, that given the nature of the insurance industry, the cash-flow test was not appropriate. An insurance company can pay its debts as they fall due out of new premiums. But those premiums in turn attract further potential liabilities which may arise beyond the reasonably near future. The position may be that there is no real possibility of the company ever being able to discharge those future liabilities, particularly if it is trading unsuccessfully, notwithstanding that it can, perhaps for a considerable period of time, pay its immediate debts as they fall due.

251 The balance sheet test does not, however, simply involve a snapshot of the balance sheet at any particular time. A company may have more liabilities than assets and yet this may be a temporary situation which the company is likely to remedy, perhaps, for example, by continuing to trade successfully, or perhaps because a debt owed is imminently due. In *Eurosail* (6), Lord Walker referred to certain passages from the judgment of Lord Neuberger, M.R. in the Court of Appeal in that case, in which Lord Neuberger powerfully emphasized this point ([2013] UKSC 28, at paras. 40–41):

"40. In the Court of Appeal Lord Neuberger MR did not disagree with anything in the Chancellor's judgment so far as it related to statutory construction. He did however go further in his detailed discussion of section 123(2). He observed (para 44):

'In practical terms, it would be rather extraordinary if section 123(2) was satisfied every time a company's liabilities exceeded the value of its assets. Many companies which are solvent and successful, and many companies early on in their lives, would be deemed unable to pay their debts if this was the meaning of section 123(2). Indeed, the issuer is a good example of this: its assets only just exceeded its liabilities when it was formed, and it was more than possible that, even if things went well, it would

> fall from time to time within the ambit of section 123(2) if the appellants are right as to the meaning of that provision.'

41 Lord Neuberger MR developed this at paras 47 to 49 of his judgment:

> '47. More generally, I find it hard to discern any conceivable policy reason why a company should be at risk of being wound up simply because the aggregate value (however calculated) of its liabilities exceeds that of its assets. Many companies in that position are successful and creditworthy, and cannot in any way be characterised as 'unable to pay [their] debts'. Such a mechanistic, even artificial, reason for permitting a creditor to present a petition to wind up a company could, in my view, only be justified if the words of section 123(2) compelled that conclusion, and in my opinion they do not.'"

252 The critical question is always whether the company will be able to pay its debts when they fall due. This is a fact-sensitive question involving an exercise of judgment, and reasonable people may disagree as to the answer.

The use of hindsight

253 In the application of the balance sheet test, it is not necessary to make that assessment solely by reference to the information known to the directors at the material time. As H.H.J. Behrens pointed out in *Re Cosy Seal Insulation Ltd.* (14) ([2016] EWHC 1255 (Ch), at para. 126), the court is "entitled to use hindsight to determine if the test is met." In support of that proposition, he referred to a decision of H.H. Judge Purle, Q.C. in *Watchorn* v. *Jupiter Indus. Ltd.* (48), in which the judge said this ([2014] EWHC 3003 (Ch), at paras. 46–47):

> "46. Looking at matters with hindsight is consistent with the earlier authority of *Ex parte Russell* (1882) Ch 588, a decision of the Court of Appeal under section 91 of the then Bankruptcy Act 1869, which was another provision relating to what would nowadays be called transactions at an undervalue.
>
> 47. In considering the debtor's insolvency at the material date, the Court of Appeal rejected an earlier assessment by the debtor and applied actual realisation values occurring three years later. That is a clear indication that it is appropriate to use hindsight, though I do not suggest that it will in every case be conclusive. This approach is also supported by the Australian case referred to by Mr Dean in argument: *Lewis v Doran* (2004) 208 ALR 385. At paragraph 108, Palmer J said:
>
> > 'Where the question is retrospective insolvency, the Court has the inestimable benefit of the wisdom of hindsight . . . By

> reference to what actually happened, rather than to conflicting experts' opinions as to the implications of balance sheets, the Court's task in assessing insolvency as at the alleged date should not be very difficult.'"

254 This is not what in fact happened in this case. EIC sought to establish insolvency by asking experts to conduct a historical reconstruction of the balance sheet, looking at what reserves should have been put into the accounts for each year from 2010 to 2014, based on information which the directors had available to them at that time. However, even if it was not strictly necessary to complicate the exercise in this way when assessing whether the company was insolvent as a matter of fact, the historical approach is important at the second stage, when asking whether the directors knew or ought to have known that the company was insolvent. Indeed, whether the directors had constructive knowledge must depend upon what information was in principle available to them at the relevant time.

The judgment below

255 On the question of insolvency, there was expert evidence from two witnesses on each side. The judge was much more impressed with EIC's expert witnesses, Dr. Brown and Mr. Ashbourne, than with the experts instructed by Mr. Flowers, Mr. Marcuson and Mr. Manning. Indeed, he accepted the evidence of Dr. Brown and Mr. Ashbourne on every point in issue between the experts. His findings on insolvency were almost entirely in line with their analysis. I shall summarize their evidence, although this is perforce a very summary and somewhat simplistic account of what are extremely detailed and sophisticated reports.

Dr. Brown's evidence

256 Dr. David Brown dealt with the question of whether the motor and Icebreaker products were properly reserved in each of the financial years ending 2010 to 2015 respectively. He produced his main report and two supplementary reports which took account of additional information, the observations of Mr. Flowers' experts, and points made in witness statements. In reaching his conclusions, he had regard to the statement of recommended practice ("SORP") issued by the Association of British Insurers and to a claims reserving manual published by the Institute and Faculty of Actuaries in 1989. Dr. Brown concluded that, in both areas, there had been significant under-reserving.

257 With respect to its reserves, EIC had been required by the Commission to commission an independent reserve review as of December 31st, 2011 and to set reserves at the best level recommended by the independent actuary. EIC appointed Towers Watson ("TW") to carry out formal reserve

estimates, which they did from December 31st, 2011 to March 31st, 2015, but only with respect to the motor business. There was no independent assessment for Icebreaker.

The motor reserves

258 As to the reserves for the potential liabilities arising from motor policies, TW had provided a range of possible estimates and identified what is termed the "singular best estimate." Dr. Brown expressed the view that whilst he would have been more cautious than TW had been, the best estimates fixed by TW for each year were within the range of what might be considered "proper," recognizing that there is inevitably an element of subjective judgment in these calculations. Dr. Brown asserted—and this was accepted by Mr. Flowers' own expert, Mr. Marcuson—that this ought generally to be the figure put into the accounts, both because in this case the Commission had in fact required this to be the appropriate figure, and because it is good market practice. However, the directors of EIC did not adopt the best estimates as the Commission required; in each year it was lower than that. According to Dr. Brown, the directors took the lower level of the range as a starting point. The directors summarized in notes to the relevant board meeting for each year the basis for their approach. The directors went below even the bottom of the range in two years (2012 and 2015) and towards the lower end of the range in two other years (2013 and 2014).

259 Dr. Brown accepted that it would be legitimate in principle to reserve at the lowest end of the range provided there was proper statistical and analytical support to ensure compliance with the relevant professional standards. In his view EIC had no such support available within the company to make a proper assessment. Dr. Brown considered the explanations for departing from the best estimates in the board notes for each year; his view was that the rationale for the reserves chosen lacked any proper justification. He concluded that the reserves put into the annual financial statements were short of the best estimates by £2.7m., £0.8m., £4.1m., and £5.4m. for the year ends March 31st, 2012 to March 31st, 2015 respectively. This was the period when EIC was involved in the motor business.

260 In addition to the under-reserving in respect of claims, Dr. Brown also held that there was an area of risk with respect to the motor policies which had not been catered for at all. This was what is termed the unexpired risk reserve ("URR"). This is a reserve designed to deal with a situation (as in this case) where the estimated claims and expenses attributable to the unexpired period of the policies exceeds the unearned premium with respect to those policies. The effect of this additional reserve was to increase the liabilities in the balance sheets. This was not a head of potential

liability which the auditors had identified and appears not to have been considered by the directors.

Icebreaker reserves

261 As I have already indicated, at no stage was any reserve put in place for the potential liabilities resulting from the Icebreaker policies. Dr. Brown took the view that the directors had displayed a lack of due diligence in various respects: failing to take proper steps to evaluate the risks at the outset; failing to obtain actuarial advice about them; and failing to re-assess them in the light of developing information. The judge essentially accepted that evidence when concluding that Mr. Flowers had been negligent with respect to reserving for these policies.

262 Dr. Brown observed that it was difficult to see how it could possibly have been thought that the policies were risk free. In his first report he referred specifically to the possibility of a defence to claims under the policy. He noted that the minutes of EIC's 2014 audit risk and compliance meeting envisaged the possibility of returning premiums to policy holders. It was there "noted that we need to reserve for a return of premium of between 0 and 30%, net of our costs." As he pointed out, had management thought that such voidance was certain, which a no-risk position would seem to assume, one would have expected the directors to have set aside a reserve of 100% for the return of the premium. The liquidator had taken the view that there were "no reasonably arguable grounds" to believe that any of the defences would succeed, and that was Dr. Brown's belief also from the materials he had seen.

263 Dr. Brown provided figures for four possible scenarios. The first two did not, in his view, provide for proper reserves. The third set of figures were in his view acceptable and were within the parameters of the range which an auditor might legitimately adopt. The fourth scenario reflected a more prudent approach which set higher reserves to reduce further the risk that the company might become insolvent.

264 In his third scenario, Dr. Brown did make some small allowance for the possibility that a defence might defeat liabilities under the policy. For the last two years, *i.e.* 2014 and 2015, he fixed this at 15%. This seems to have been chosen as the mid-point between the 0% and 30% which the board had identified as the possible level of voidance in the audit risk and compliance meeting in 2014.

265 In his first supplementary report, Dr. Brown revisited this issue in the light of additional information and the views of Mr. Flowers' experts, Mr. Marcuson and Mr. Manning. They were putting considerable weight on these defences and considered that the decision not to make any reserve for potential liabilities was justified. By then the Financial Ombudsman had upheld the argument that it would be contrary to public policy for EIC

to have to pay out with respect to a tax avoidance scheme. Dr. Brown was still not persuaded that there was any merit in these defences and did not alter his scenario 3 figures. He did, however, make a calculation based on a 30% probability that the defences might succeed, simply by way of illustration in case the court considered that he had underestimated the possible effects of these defences. But this was not the calculation used by Mr. Ashbourne when adjusting the balance sheet.

Mr. Ashbourne's evidence

266 Mr. Ashbourne is a very experienced accountant specializing in insolvency and insurance restructuring. Whereas Dr. Brown had dealt with the historic valuation of liabilities with respect to the motor and Icebreaker policies, Mr. Ashbourne focused on whether, taking that evidence into account together with other adjustments which he felt ought to have been made in the accounts, EIC had been insolvent prior to going into liquidation in 2016. His conclusion was that it had been insolvent from 2010 onwards, both on a going concern and on a break-up basis. All of his proposed adjustments were accepted by the judge who was satisfied that the company had been "hopelessly insolvent."

267 Essentially, Mr. Ashbourne identified three areas where adjustments should, in his view, have been made, in addition to those identified by Dr. Brown. The first related to an asset in the balance sheet with respect to the ATE insurance policies, referred to as the legacy control account ("LCA"). This arose from the fact that when the policies were first incepted, commission was paid to various introducers. Some of this was up-front commission but some was secondary commission, which was not guaranteed and depended on the total value of the claims made under the policies. This was recorded in the accounts as an expense. However, some introducers agreed to take this element of the commission as preference shares. The effect of that was that what had been a contingent liability to pay a commission was now a contingent right to a dividend payment. This required an amendment to the accounts, and the LCA was an accounting device designed to deal with the change. There appears to have been no issue about the principle (or if there was, it was clarified in Mr. Ashbourne's second report), but Mr. Ashbourne took the view that the total of the balances in the LCA relating to the preference shareholders (and the corresponding reduction in the liabilities) was too high; essentially, it had exaggerated the number of introducers switching to the preference share option. Mr. Newing, in his witness statement, apparently challenged this but he did not in the event give evidence, and the judge accepted Mr. Ashbourne's figures.

268 Second, there was an adjustment relating to the 8% MSA account. It was treated as a deferred acquisition cost ("DAC"). Mr. Ashbourne had considered that even if EIG had been providing the range of services which

some of the directors claimed it was doing, very few of these could be said to fall into the category of acquisition costs. The logic of this is that if no services were provided, it could not be a DAC. In Mr. Ashbourne's view, it simply had to be written off.

269 Third, Mr. Ashbourne's evidence was that there was a strong likelihood that once the full extent of under-reserving had been appreciated by the Commission, it would have required EIC to stop trading and run off the business. Whether or not EIC was insolvent, the solvency margins would have been such that there was every likelihood that the Commission would require this. Some provision was necessary to deal with the cost of the run-off. This in fact significantly increased the extent to which liabilities exceeded assets. This adjustment would only arise, however, if the other adjustments would in themselves significantly reduce the solvency margins. A company does not actually have to be insolvent before a run-off is required, but it is likely to be very close to insolvency before that step is taken.

270 In the light of all these factors, Mr. Ashbourne produced a table to reflect the adjustments which he considered necessary to qualify the balance sheets which EIC had produced in each of the relevant years. Mr. Ashbourne concluded that EIC was insolvent in each of those years, the extent increasing with each year. Moreover, on his analysis, its liabilities exceeded its debts by a very considerable margin. The key figures (to the nearest tenth of a million) were as follows:

Years	Annual accounts	Excess of liabilities	Excess of liabilities
2010	5.2	(11.8)	(12.5)
2011	9.2	(15.6)	(17.7)
2012	14.3	(23.8)	(29.2)
2013	17.6	(26.5)	(33.0)
2014	20.8	(28.1)	(43.2)
2015	16.4	(37.4)	(52.0)

(This was his analysis of the solvency of the business on a going concern basis; he also carried out an analysis on a break-up basis when the insolvency was even more severe.)

271 The judge accepted all these figures and in fact he thought that the Icebreaker reserve should be increased and placed in scenario 4 rather than scenario 3. This was apparently because Dr. Brown had given evidence to the effect that if Mr. Flowers had actually known that only 20% of the investment was put at risk, which the judge found to be the case, scenario 4 was appropriate. I confess to having difficulty with Dr. Brown's reasoning on this point. The appropriate reserves should surely be based on the objective facts, not what Mr. Flowers might mistakenly have believed

them to be. If scenario 3 identifies an acceptable premium range, I would have thought that must be for someone properly appreciating the nature of the relevant risks. Accordingly, I find difficulty in understanding why the relevant scenario should change depending upon Mr. Flowers' subjective understanding of the facts. However, in the event nothing turns on this in the appeal.

The grounds of appeal relating to insolvency

272 There were, as I understood the argument, three grounds on which counsel for Mr. Flowers took issue with the way the exercise was undertaken by Mr. Ashbourne, quite apart from detailed challenges to each of the adjustments made.

273 First, it was said that it was not good enough simply to make a calculation of assets and liabilities as a snapshot at a particular time and to assume that because there is an excess of liabilities, a company must be insolvent. As *Eurosail* (6) and other authorities show, there has to be a careful analysis of when liabilities will become due and whether by then the company might be in a position to pay them. Second—and this is really a related argument—it should have been recognized that historically when EIC had been close to insolvency, a capital investment had been made. Mr. Ashbourne had made no allowance for this possibility. Third, it was inappropriate for the liquidator simply to re-write the balance sheet without any reference to, or consideration of, the accounts approved by previous auditors. The starting point should have been that their audits were appropriate, at least unless there were strong reasons to think otherwise.

274 In principle, there is in my view merit in the first point, which is supported by the authorities discussed above. Neither Mr. Ashbourne nor the judge appears to have formally recognized that the balance sheet test requires a careful and sensitive analysis of the nature of the liabilities and when they are likely to fall due. But that is perhaps because in this case, on Mr. Ashbourne's analysis at least, the extent of the shortfall of assets to liabilities was so stark that it was quite unrealistic to believe that the prospective liabilities could possibly be paid. This conclusion was reinforced by the fact that even Mr. Flowers' own expert, Mr. Manning, accepted that EIC's principal business, the motor business, had not been profitable in the years 2012, 2013 and 2015. There was no realistic hope that EIC's business fortunes would improve sufficiently to warrant the inference that these not inconsiderable liabilities could be paid from future profits.

275 Nor, in my judgment, would it have been appropriate to assume that there would have been relevant capital investments sufficient to keep the company afloat. It is true that EHL had hitherto provided capital to EIC as and when required, which was intended to keep it at least solvent even if

falling short of the RMM. But there was no legal obligation on EHL to use its money in that way, and it may well not have had the funds to do so given the extent of the asset shortfall. There could be no confident expectation that funds would have been provided had the insolvency become apparent earlier.

276 As to the third ground, it was for the liquidator to show that EIC was insolvent in the relevant years, but I agree with the judge that he was entitled to do that by producing his own evidence on the point. That evidence could be, and was, challenged, including by reference to the analysis by earlier auditors. As the judge said (2034/GSC/008, para. 878), whether EIC was insolvent was an objective question and "how third parties viewed EIC's balance sheet does not provide an answer to this part of the case." There is no assumption that the original audits were correct, and Dr. Brown and Mr. Ashbourne gave their reasons why they did not believe that they were. However, the fact that previous auditors have taken a different view is certainly relevant to the question of whether the directors ought to have known that the company was insolvent, and I return to this issue in that context.

The detailed challenges

277 I will deal briefly with the detailed challenges to the individual items. They faced serious difficulties for two reasons in particular. First, as I have said, the judge preferred the liquidator's expert witnesses to Mr. Flowers' experts. He was entitled to do that, and at various points in his judgment he gave cogent reasons for so doing. Second, it was always recognized that Mr. Newing was a very important witness for Mr. Flowers when dealing with the detail of some of these issues. In particular, his evidence was critical in challenging Mr. Ashbourne's contention that the LCA figures had been significantly exaggerated, yet Mr. Flowers, knowing this, chose not to call him. (I discuss this further in the next section of this judgment.) It was almost inevitable in these circumstances that the judge would accept Mr. Ashbourne's evidence, particularly given that he had carried out his own quite careful analysis of the relevant documents. Counsel strongly argued that the dispute about the figures themselves was not properly raised on the pleadings. But this was a point only made by Mr. Flowers in his closing observations to the judge, and Mr. Newing's witness statements (six in all) were in part directed to the point, and he was fully prepared to deal with it, had he been called.

278 As to Dr. Brown's evidence, a specific complaint with respect to the motor reserves was that the directors had given cogent reasons for not selecting the best estimate. But Dr. Brown rejected their explanation, and the judge was entitled to accept his evidence. Similarly, Dr. Brown's estimation of the appropriate reserves each year for Icebreaker, and how he

reached the figures he did, was fully explained. I would also point out that with the benefit of hindsight, we know that the tax relief was not granted, and—on the assumption at least that this judgment is correct on the point—that Dr. Brown was right to make the assumption (save for a minor qualification) that neither cl. 11.4 nor public policy provided a defence against the Icebreaker liabilities.

279 In my view, therefore, the judge was entitled to find that as a matter of fact EIC was insolvent from June 30th, 2010 onwards. The evidence which he accepted, and for the reasons he gave, fully justified that conclusion.

The second condition: actual or constructive knowledge

280 The second condition required to trigger the creditor duty is that the director either must know or ought to know that the company is insolvent. The judge was satisfied that Mr. Flowers satisfied that condition. He said this (para. 906):

> "This is a case where Mr. Flowers, amongst other things, clearly under reserved on the motor book and recklessly on the Icebreaker book of business. In my view if he did not know about EIC's true state of insolvency, it is something he ought to have known about."

281 The judge did not find that Mr. Flowers knew that EIC was insolvent, but he left the possibility open. I do not think this was fair to Mr. Flowers. As I have mentioned, he put substantial businesses of significant value—he submits worth £6m. but even if that is exaggerated they were still assets of real worth—into the Enterprise group in 2015. That is hardly the action of a man who knew that EIC was insolvent; indeed, the only reasonable inference is that Mr. Flowers did not know that EIC was insolvent.

282 The judge quoted from a passage in the judgment of John Randall, Q.C., sitting as a deputy High Court judge, in *Hellard* v. *Carvalho* (20), where the judge made the following observation as to what constituted knowledge of insolvency ([2013] EWHC 2876 (Ch), at para. 95):

> "[T]he law's general approach to such questions . . . is that the requisite knowledge is of the facts which give rise to the relevant legal consequence (here, actual or potential insolvency)."

283 I do not think that this is directly relevant to the facts of this case. I believe that all the judge there was saying was that if a defendant knows the facts from which a reasonable person would infer that a company is insolvent, he cannot avoid liability by asserting that he did not subjectively appreciate that fact. In this case Mr. Flowers did not know of the adjustments which, with hindsight, can be seen to have made EIC insolvent

from 2010 onwards. The question is whether he ought to have known of them.

284 In *Singer* v. *Beckett*, the issue was whether the directors of an insurance company were liable for wrongful trading. That depended upon whether they knew or ought to have known that the company was insolvent. Mr. Justice Park described the role of the director of such a company with respect to accounting issues in the following terms ([2007] 2 BCLC 287, at para. 258):

> ". . . I am not suggesting that it would have been acceptable for them to be totally ignorant of accounting concepts as applied to an insurance company. In my view they would have been expected to be intelligent laymen. They would need to have a knowledge of what the basic accounting principles for an insurance company were, such as IBNR. They would be expected to look at the company's accounts and, with the guidance which they could reasonably expect to be available from the finance director and the auditors, to understand them. They would be expected to be able to participate in a discussion of the accounts and to ask intelligent questions of the finance director and the auditors. What I do not accept is that they could have been expected to show the sort of intricate appreciation of recondite accounting details possessed by a specialist in the field . . ."

285 The judge below did not accept that this case provided any succour to Mr. Flowers. He concluded thus (2034/GSC/008, at para. 906):

> "In my view this is not a case like *Singer* v. *Beckett* which concerned intricate and technical accounting details which it would have been unrealistic for Mr. Flowers to have grappled with. This is a case where Mr. Flowers, among other things, clearly under-reserved on the motor book and acted recklessly on the Icebreaker book of business. In my view, if he did not know about EIC's true state of insolvency, it is something that he ought to have known about."

286 It is relevant to note that although Mr. Flowers was an experienced and successful businessman, he was not a qualified accountant. In my judgment it is quite unrealistic to believe that Mr. Flowers should have known that the adjustments identified by Mr. Ashbourne relating to the LCA, the DAC or the provision of reserves for a run-off ought to have been included in the balance sheet. He could reasonably assume that these matters had properly been dealt with by the professionals. Nor could he be expected to have known that the accounts should have included, with respect to the motor business, the URR entry to deal with the fact that the expenses and liabilities for the unexpired period of the policies were expected to exceed the value of the unearned premiums. These are in large part technical questions about the methodology of accounting, and in part

disputes over whether the figures have been properly determined. Although as a director Mr. Flowers was under a duty to satisfy himself that there was nothing obviously untoward about the accounts, it is not suggested that he deliberately deceived the auditors or had reason to believe that the audited accounts might be inadequate, at least with respect to the Ashbourne adjustments.

287 In fairness to the judge, he did not expressly put weight on these factors in order to establish constructive knowledge. Rather he focused on an aspect of the motor reserves, and the lack of any Icebreaker reserve.

288 As to the motor adjustments, it is only the LCA element for which Mr. Flowers might fairly be said to bear responsibility for under-reserving, by failing to adopt the best estimate. This was the reserve which the Commission required EIC to adopt. However, the Commission was more concerned to ensure that the RMM was maintained rather than bare solvency. It is true that in the annual auditors report and notes to the financial statements, auditors regularly raised queries about the best estimate not being adopted. However, this was principally because they were concerned about the risk that any under-reserving might result in the RMM not being achieved which could in turn lead to action by the Commission which could jeopardize EIC's ability to operate as a going concern. Moreover, the alleged under-reserving was relatively small, particularly in comparison with the reserves which it is alleged ought to have been in place with respect to the Icebreaker risks. This adjustment did not, on its own, begin to make EIC insolvent.

289 The real issue, in my judgment, is whether the judge was entitled to find that Mr. Flowers ought to have known that, had appropriate reserves been calculated for potential liabilities arising out of the Icebreaker policies, the inability or failure to provide such reserves would have meant that EIC would have been insolvent for each year from June 30th, 2010 to 2016. I agree—and have found—that the judge was entitled to conclude that Mr. Flowers (and no doubt the other directors) ought to have appreciated that some reserves were necessary; he cannot hide behind his own negligence and claim that he did not realise that. But ought he to have appreciated that the inability or failure to set the appropriate reserves would have made EIC insolvent?

290 On Dr. Brown's analysis, the appropriate Icebreaker reserves would *on their own* have made EIC insolvent in each of the years from 2010 onwards, quite independently of the other adjustments which the judge accepted ought to have been made. The extent of the insolvency from Icebreaker alone was as follows (all figures to the nearest tenth of a million):

Financial year end	Accounts	Icebreaker required reserve	Insolvent by
2010	5.2	(13.4)	(8.2)
2011	9.2	(19.0)	(9.8)
2012	14.3	(21.7)	(7.4)
2013	17.6	(24)	(6.4)
2014	20.8	(28)	(7.2)
2015	16.4	(28.1)	(11.7)

(The financial years ended on June 30th, in 2010 and 2011 and thereafter on March 31st. The heading "Accounts" refers to the excess of assets over liabilities in EIC's annual accounts.)

291 A key feature of this analysis is that it is premised on the assertion that the defences had no prospect of success, save for a small 15% possibility that they would, which possibility was built into the calculation of the reserves for the years 2014 and 2015 only. The potential significance of this is that this is not a matter on which Dr. Brown had any expertise, and indeed he quite properly relied significantly on the advice which the liquidator had received as to the strength of these defences.

292 However, I do not think that it would be fair to assume that Mr. Flowers ought to have appreciated that these defences would fail. He could not reasonably have been expected to take the view that cl. 11.4, which was plainly intended to provide some defence to EIC, would in practice be entirely worthless.

293 Moreover, when in 2014 it became clear that the tax relief would not be available, the legal advice given suggested at least that there were some prospects that either cl. 11.4 or public policy, or indeed both, would provide a complete defence to the claim. The judge found, as he was entitled to do, that Mr. Flowers had not provided proper information to the lawyers, in particular failing to make it clear that the loaned moneys were not invested. It was on the assumption that they were that the lawyers asserted, in the Dutton letter, that one reason why the policy holders could not recover under the Icebreaker policies was that they had misrepresented the nature of their investments. But whilst that defence was the result of false information being provided by Mr. Flowers and was not subsequently pursued, the possibility of the other two defences applying would not have been affected by any misleading information given by Mr. Flowers. The lawyers themselves would take a view on the potential impact of the cl. 11.4 and public policy defences. They must have thought that they had at least some prospect of success in order to consider it appropriate to put them in the letter. Furthermore, the Financial Ombudsman and subsequently the courts thought that there was merit in the public policy

defences, and until the liquidator took a different view, the Dutton letter was effective in successfully resisting claims from Icebreaker policy holders.

294 In this context I would also give weight to the fact that neither the internal finance officers nor the auditors had raised any concerns about the potential insolvency of the company. I appreciate that it is ultimately the duty of the directors to determine the appropriate reserves but they will inevitably have to rely upon the advice and assessments of the professionals, the finance director and the external accountants. It is not enough to say, as the judge did, that there is evidence which objectively establishes the insolvency; in my judgment it is necessary to have regard to all matters potentially bearing on what the directors ought reasonably to have appreciated. In that context it is highly material, in my view, that none of the auditors for any of the years in question have concluded that the company was insolvent or even suggested that it might be. Indeed, annual solvency reports, showing transactions between companies within the group, had been signed off. It is true that the auditors expressed concerns about the adequacy of reserves in 2014 and 2015 (although the accounts had been signed off on a going concern basis until 2014) but this was not specifically directed at the lack of Icebreaker reserves, and if there were concerns on that score, one would have expected the issue to be highlighted from the first year when no reserves were included for Icebreaker. If, for example, the auditors' position was that they had not checked the basis for the assumption that no reserves were necessary, I would have expected that to be noted, together with an indication of how central the accuracy of this reserve was to the potential solvency of the company. I appreciate, too, that the company has failed to meet the RMM in almost every year, and this would have been something which Mr. Flowers in particular ought to have appreciated (and almost certainly did). Moreover, for reasons I have already briefly touched upon (see para. 137 above), that might have been enough to make the MSA and PIE payments unlawful as *ultra vires* payments. But none of this suggests that the company was insolvent.

295 As I have said, Dr. Brown provided a revised version of scenario 3 to take account of the possibility that there may have been a 30% chance of the defence succeeding. This would in fact still have meant that the Icebreaker reserve would have exceeded the assets in all years except 2013, but for the other years the excess would be significantly reduced, such that it might well be realistic to have regard to the fact that if this were the full extent of the liabilities, capital may well have been injected into the company at that stage had it been necessary to do that. Of course, as the probability measure of the defences succeeding increases, the likelihood of liabilities exceeding assets decreases.

296 The judge made two points potentially relevant to the position of the auditors. The first is that the auditors for the relevant years had, according to his interpretation of their evidence, failed to look properly at the

methodology and assumptions of the directors when setting reserves. That is relevant when determining why the judge preferred the analysis of Dr. Brown to the conclusions of the auditors as to whether the company was in fact insolvent. But it does not, with respect, provide an answer to Mr. Flowers' reliance on their reports. He was surely entitled to assume that they had undertaken their task properly and responsibly.

297 The position might be different if there were evidence of Mr. Flowers knowingly seeking to deceive the auditors as to the true state of the company's affairs. But that has not been alleged. It is also of some weight that although the Commission had identified many areas of concern, it had not raised insolvency as one of them.

298 The second point referred to by the judge was that this was not a complex case where Mr. Flowers could not be expected to understand the accounting intricacies. It was one where the failure to make adequate reserves should have been obvious. But as I have indicated above, in my view that is only a realistic observation with respect to the Icebreaker reserves and, even then, the failure to make proper reserves does not mean that the error would necessarily have led to insolvency, or that Mr. Flowers should have appreciated that it would do so. Nobody appears to have been concerned that it would, notwithstanding that the lack of any reserve for Icebreaker liabilities was plain for all to see.

299 In my view the judge's analysis of this part of the case cannot stand because he has not given any weight to these material considerations. We should determine this issue afresh. Although I have not found this an easy issue to determine, on balance I do not think it would be justified to infer that because Mr. Flowers was negligent in failing to take steps to enable proper reserves to be set for Icebreaker, he should also have appreciated that a failure to do so would necessarily have meant that EIC was insolvent, simply as a result of that adjustment, from 2010 onwards.

300 I would not, therefore, find that the creditor duty arose. It follows that there was no breach of fiduciary duty on this ground when making the MSA or PIE payments, and ratification was not excluded on this ground either. Nothing turns on this, however, since I have found that the requisite MSA and PIE payments were unlawful and were not capable of being ratified for other reasons.

The fairness of the trial and related procedural complaints

301 This was an unusual trial. Mr. Flowers had been legally represented in all stages leading up to the trial and for the first four days of the trial itself. His counsel then was Mr. Channer, who also acted for another defendant, Mr. Longstaff, who subsequently settled with EIC. Mr. Flowers says that he could not afford to pay both for counsel and his two expert witnesses, and he chose to dispense with the former. Mr. Channer was dis-

instructed on the fifth day of the trial. Thereafter Mr. Flowers represented himself, although he did have some legal assistance in drafting his closing submissions.

302 Mr. Flowers' principal submission is that the trial was unfair, and the judge ought not to have allowed it to proceed, without Mr. Flowers being legally represented. The case raised complex areas of law and it covered events over some eleven years. After Mr. Longstaff had settled his case, Mr. Flowers was the only remaining defendant. He had to address issues such as insolvency, without any technical knowledge or relevant experience. Mr. Flowers' counsel have conceded that this was a difficult situation for the judge, and they have accepted that the judge did his best. Nonetheless, it is alleged that the judge failed to deal with the circumstances fairly. He ought not to have allowed Mr. Flowers to continue to represent himself in person: it rendered the trial unfair.

303 An important feature of this case is that at no time did Mr. Flowers seek a stay or an adjournment to give him the opportunity to seek funding, neither did his then counsel suggest it when ceasing to act for Mr. Flowers. Indeed, as the judge records in his judgment, when Mr. Channer was dis-instructed, Mr. Flowers said he was ready to proceed on his own.

304 The basis of this challenge, therefore, must be that the judge ought of his own motion to have adjourned the case presumably unless and until Mr. Flowers was able to obtain legal representation, however long that might prove to be. Moreover, he should have done so notwithstanding that Mr. Flowers had said in terms that he was ready to proceed.

305 I fully accept that in principle it is the duty of a judge to refuse to continue with a trial if he or she believes that a fair trial is not possible. This may be, in an appropriate case, because it is unfair to expect a litigant to defend himself: see *e.g. Airey* v. *Ireland* (2). The right to a fair trial is a fundamental human right, protected by the law of Gibraltar and art. 6 of the European Convention on Human Rights. Exceptionally, the right to a fair trial will require that a litigant is represented, and there may be a duty on the state to secure representation: see *e.g. Steel* v. *United Kingdom* (41). That was an extremely complex defamation case brought by McDonald's against two members of London Greenpeace. It was held to be a breach of art. 6 to conduct the trial without legal representation. There was then no right to legal aid in a libel trial and the defendants could not afford to employ lawyers. Mr. Flowers accepts, however, that that case was more complex than this; also, the defendants did not have the degree of legal assistance which was available to Mr. Flowers both before, and to a limited degree even after, Mr. Channer was dis-instructed. Detailed legal argument had been provided in counsel's skeleton arguments, witness statements had been prepared, and counsel had opened Mr. Flowers' case.

306 I do not doubt that Mr. Flowers was disadvantaged to some degree by the absence of a legal representative for the whole duration of the trial, and I mention some of those areas below. But such disadvantage of unrepresented litigants is a common feature of litigation and does not begin of itself to render the trial unfair. This was not a case where it was suggested that, if there were an adjournment, Mr. Flowers might find the funds necessary to obtain representation. A refusal to adjourn for that purpose might conceivably have been unfair, at least if there was cogent evidence that representation was a real possibility. But Mr. Flowers was ready to proceed. He is a very capable, strong-minded, and experienced businessman who had detailed knowledge of most of the issues raised at trial. In those circumstances it is hardly surprising that the judge carried on.

307 Moreover, the judge was acutely aware that efforts should be made to assist Mr. Flowers during the trial given his status as a litigant in person. The judge went out of his way to seek to ameliorate the difficulties faced by Mr. Flowers. For example, he allowed Mr. Flowers to make notes whilst being cross-examined, to be used as a reminder for points he might want to make by way of what the judge termed "re-examination," which I take to be a shorthand for the opportunity he was given to make a further speech under oath as to matters he wanted to add or qualify to the oral evidence he gave in cross-examination. Mr. Flowers was also allowed to make the re-examination part of his closing submissions, which gave him longer time to prepare. Furthermore, before Mr. Flowers started his re-examination, the judge provided him, by way of an *aide memoire*, with an overview of the points raised in his cross-examination to which he might wish to respond.

308 In my judgment, this is far removed from the very exceptional case where lack of legal representation renders the trial unfair. Indeed, the judge noted that Mr. Flowers was a "skilled advocate who rose to the challenge of defending himself in court." Having seen Mr. Flowers' closing submissions at the trial, I have no doubt that this was a fair description. I would therefore dismiss this aspect of the appeal.

Issues arising during the trial

309 Mr. Flowers also complained about the way in which the judge dealt with certain issues arising during the trial. Some of these complaints have constituted the grounds upon which Mr. Flowers has sought to challenge particular decisions of the judge. For example, it is said that it was unfair for the judge, when dealing with Icebreaker 2, not to consider whether there had been a loss before finding that the tort had been committed. Another is that the judge did not give a ruling on whether the defences of cl. 11.4 or public policy applied. These alleged errors by the judge have been addressed in the body of the appeal, and have been in part successful. An error of law of this nature does not make the trial unfair; the process allows for an appeal court to put it right.

310 A major complaint is about the way potential witnesses were dealt with by the court. Many of the original defendants had made witness statements but once their cases settled, they did not give evidence. Some, like Mr. Cruz and Mr. Jacobson, did so but many former directors did not. However, Mr. Flowers could have called them and had a summons issued if they refused to appear voluntarily. It was not for the judge to call them. Nor would it have been open to the court simply to have accepted the assertions in their witness statements when they had not been either sworn to or affirmed in the witness box, let alone tested by cross-examination; that would have been unfair to EIC.

311 In the skeleton argument for Mr. Flowers, it was suggested that it was unrealistic to think that he could have called, as witnesses, defendants who had settled with the liquidator. The point was put rhetorically: "what, anyway, were these witnesses going to say?" One would anticipate that they would say what is in their witness statements. If there is real doubt about that, there is every reason to suppose that the witness statements are unreliable. That is one reason why it would be wrong to treat untested witness statements as evidence.

312 A key potential witness was Mr. Newing. It had been said during the trial both by Mr. Flowers' counsel, Mr. Channer, and by Mr. Flowers himself, that only Mr. Newing could give relevant evidence on some issues, notably those relating to insolvency. As finance director, he could explain aspects of the accounts which Mr. Flowers was unable to do. However, Mr. Flowers made a considered decision not to call him, saying that the evidence supporting his case was already compelling, and that Mr. Newing would not add anything further. The judge asked Mr. Flowers to reflect on his decision and pointed out some of the potential consequences of not calling Mr. Newing. These included the fact that Mr. Flowers could not rely on the untested evidence. Mr. Flowers did not change his mind and the witness summons for Mr. Newing was set aside.

313 In the light of this, and after considering in some detail the relevant law on the topic, the judge held that in the circumstances, and where appropriate, he was entitled to draw adverse inferences from Mr. Newing's failure to give evidence. Mr. Newing had played a central role in many of the key issues before the court and potentially had important evidence to give. Indeed, he had provided detailed and lengthy witness statements. As the judge pointed out, in addition to the critical evidence he had to give about the accounts, he could have explained what he meant in some of the—on the face of it at least—more damning emails he had written.

314 Although it has been submitted that it was unjust for the judge to draw adverse inferences from the failure to call Mr. Newing, I can see no justified criticism of that decision. It was entirely in accordance with the relevant legal principles, and it cannot be said to have been unfair, given

the warning given to Mr. Flowers about the potential consequence of choosing not to call Mr. Newing.

315 Given that the decision not to call Mr. Newing was made by Mr. Flowers, with knowledge of some of the potential implications, it does not sit well with three other problems he has identified about the lack of legal representation. The first is that he was disadvantaged when having to deal with accountancy and related insolvency questions. But he did have the benefit of expert assistance on these matters, albeit that the judge did not in the event find their evidence convincing. Moreover, a significant problem with relation to the accounts was that he could not challenge the factual basis of much of the evidence against him because of the lack of any evidence from Mr. Newing. That was a wholly predictable consequence of not calling Mr. Newing as a witness.

316 The second is the claim that he was disadvantaged as a litigant in person about which witnesses to call and on which issues. Yet he had very clear indications here that he should call Mr. Newing but chose not to do so.

317 The third problem raised by counsel was the failure of EIC, acting through the liquidator, to call Mr. Chichon. He had been Head of Insurance Accounting and took over from Mr. Newing as finance director early in 2015. He continued to work for the liquidator after liquidation and was not made one of the defendants in the proceedings. It is said that he would have confirmed certain aspects of Mr. Flowers' case, such as the valuable use of the triangular model. It was alleged that the judge ought to have been prepared to draw adverse inferences against the liquidator from the failure to call Mr. Chichon.

318 The odd feature of this complaint is that Mr. Chichon was, until he became finance director, answerable to Mr. Newing. The latter would have been the obvious person to call to deal with matters with which both men were involved. Furthermore, Mr. Flowers and others had added Mr. Chichon as a Part 20 defendant in 2019, and he could have called Mr. Chichon as a witness. I see nothing in this complaint.

Particular areas of difficulty

319 Counsel emphasized two areas where Mr. Flowers had been disadvantaged and had felt unfairly dealt with. One was insolvency. For reasons I have given, that was in no small part due to his own decision not to call Mr. Newing, and he did have the benefit of expert witnesses. A particular complaint was that the judge did not give weight to the fact that Mr. Flowers was reliant on the company auditors and could not be expected to have understood the intricacies of accounting. In the event, I have seen merit in that argument and found in Mr. Flowers' favour on that aspect of the case, so any unfairness has had no adverse consequences.

320 The second area was dishonesty. It is said that Mr. Flowers was not able to persuade the judge to consider all the factors relating to the question of dishonesty. For reasons I have already given, I accept that the judge ought to have referred to one matter particularly relied upon by Mr. Flowers, namely that he had put some of his own businesses into Enterprise, at least partly to meet the Solvency II requirements. As I have said, this was powerful evidence to show that he did not actually know that EIC was insolvent before it went into liquidation. I also accept that it shows that he was not indifferent to the well-being of EIC. This was not a Ponzi scheme. But the finding of dishonesty in relation to the MSA and related transactions was on a much narrower basis, essentially that, in improperly taking money out of EIC for a variety of reasons unconnected with its best interests, he had acted in bad faith. That is not to say that he was dishonest in all his dealings with EIC. However, the fact that he was willing to use his own properties to assist the company was not relevant to the basis of the dishonesty finding made against him.

321 There were further concerns floated in argument about the conduct of the liquidator in discharging his functions, and doubt was cast upon his motives in pursuing some of the issues in this trial. There had been an earlier hearing when the liquidator amended the statement of claim to add dishonesty allegations. This was opposed by Mr. Flowers in part on the grounds that the liquidator had a collateral purpose for seeking to run this argument, relating to a defamation action between the parties. The judge rejected the allegation of improper conduct and his ruling to allow the amendment was not appealed.

322 These criticisms of the liquidator did not properly engage the court in this appeal, and they seem to have been based on speculation rather than any solid evidence. In any event, any ill motive of the liquidator may have justified an attempt to have him removed from office, but they do not bear upon the issues in the case. Whether the claim is justified or not depends on an objective analysis of the evidence of events which happened before the liquidator was appointed.

323 For these reasons, therefore, I would reject all the allegations relating to procedural unfairness.

Conclusions

324 In summary, my principal conclusions are as follows:

(1) I would reject the appeal directed against the judge’s findings with respect to MSA, PIE and related matters. The judge was entitled to conclude that Mr. Flowers acted dishonestly and in breach of his fiduciary duty to act in the best interests of EIC and also acted in breach of his duty of care.

(2) I would also reject the submission that the unlawful acts either had been ratified as a matter of fact or could in the circumstances be ratified as a matter of law. In that context, however, I would reject the judge's conclusion that one of the reasons why ratification was not possible was that Mr. Flowers ought to have known that EIC was insolvent from 2010, with the consequence that unlawful transactions were not thereafter ratifiable by the shareholders.

(3) In relation to the issue of loss arising out of the breach of fiduciary duty, I would uphold the appeal against the judge's refusal to set off the payments made by EHL to EIC for shares in EIC against the losses resulting from the breach of fiduciary duty. I do not, however, accept that any part of the start-up capital ought also to have been set off.

(4) I would dismiss the appeal against the judge's finding that Mr. Flowers breached his common law duty to exercise reasonable care and skill when he wrote the Icebreaker business on behalf of EIC.

(5) I would also reject the related submission that whether he was negligent or not, either cl. 11.4 of the Icebreaker insurance policy or public policy provided a full defence against any potential liabilities which may arise out of the Icebreaker policies.

(6) I would allow the appeal against the judge's finding that Mr. Flowers breached the creditor duty on the grounds that he neither knew nor ought to have known that EIC was insolvent from June 30th, 2010. The judge was, however, entitled to conclude on the evidence that EIC was insolvent from that date onwards.

(7) I would reject the submissions that it was unfair to continue the trial without Mr. Flowers being provided with legal representation. Nor would I accept that the judge made other material procedural errors in the course of the trial.

325 **RIMER, J.A.:** I agree.

326 **KAY, P.:** I also agree.

Judgment accordingly.