[2002] EWHC 3093 (Ch)
CLAIM No. HC0101139

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand, London WC2A 2LL

Monday 22nd July 2002

Before:

JONATHAN CROW
(SITTING AS A DEPUTY JUDGE OF THE HIGH COURT)

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(1) EXTRASURE TRAVEL INSURANCES LIMITED
(2) TRANS CONTINENTAL INSURANCE INTERMEDIARIES LIMITED

Claimants

-and-

(1) ALAN HERBERT SCATTERGOOD
(2) JONATHAN BEAUCLAIR

Defendants

PAUL NICHOLLS (instructed by **Humphreys & Co**) for the Claimants
GRAHAM CHAPMAN (instructed by **K.A.C. Bentley**) for the Defendants

Judgment

(as approved by the Court)

1. INTRODUCTION

(a) The case in outline:

1.This is a claim for breach of fiduciary duty against two former directors of Extrasure Travel Insurances Limited ("Extrasure").

2. In August 1999, both the First and Second Defendants ("Mr Scattergood" and "Mr Beauclair" respectively) were directors of Extrasure. It is common ground that, on the 17th August 1999, they both signed a fax from Extrasure to its bank, Royal Bank of Scotland plc ("RBS"), instructing the bank to transfer £200,000 from the company's "IBA a/c No. 20833257" to an account in the name Inbro Holdings Limited ("Inbro Holdings"). The fax also instructed RBS to convert this sum into US Dollars, and to transfer the resulting sum to an account in the name of Inbro Citygate Insurance Brokers Limited ("Citygate"). Finally, the fax instructed RBS to pay "the transfer" from Citygate's account to an American company called United Capitol Insurance Corporation. No separate "transfer" has been put in evidence, but it would appear to have referred to the US Dollar equivalent of about £114,000.

3. The Claimants allege that the decision to transfer of £200,000 out of Extrasure's bank account, and the instruction to RBS, represented a breach by the Defendants of their fiduciary duties. By amendment at trial, the Claimants also allege that the Defendants were acting *ultra vires*. This is the first claim, and it occupied most of the 5 day trial.

4. There is also a second claim against Mr Scattergood alone. It is said against him that he told the Second Claimant, Trans Continental Insurance Intermediaries Limited ("Trans Continental"), that he had not been responsible for any inter-company transfers, such as the transfer of £200,000 from Extrasure to Citygate, and on that basis Trans Continental agreed to employ him. It is said that Trans Continental would not have employed Mr Scattergood if it had known the truth about his participation in the transfer of £200,000. The claim against Mr Scattergood is framed in terms of deceit, alternatively negligent mis-statement. On that basis, Trans Continental claims damages in lieu of rescission of Mr Scattergood's employment contract (the contract having already come to an end).

5. Although the bare fact that £200,000 was transferred on the 17th August 1999 is not in dispute, the legal claims mounted by the Claimants are all hotly contested by the Defendants. In order to resolve these legal issues, it is necessary to consider the circumstances in which the transfer was made in some detail.

6. Before turning to the facts, I will first explain the relevant corporate structure, and then identify the various personalities involved.

(b) Inbro Holdings and its subsidiaries:

7. In mid-1999, Extrasure was trading as an insurance intermediary. It sold a number of different insurance products, the majority of which were underwritten by a company called Independent Insurance. As such, Extrasure's income consisted of premiums paid by policy-holders, and its principal outgoings consisted of the sums due to underwriters. The difference between these two figures represented its commission. Extrasure operated a single bank account with RBS, which was described as an "IBA account" - an Insurance Brokers Account. Whether or not that label was strictly appropriate, in the sense that it might imply that the account was governed by some regulatory regime applicable to insurance brokers, is immaterial: in fact, as an insurance intermediary, Extrasure was not regulated by Lloyd's or by the Insurance Brokers Act. What matters for the purposes of the present dispute is the simple fact that, after the deduction of appropriate commission, the money held in Extrasure's bank account would be due to underwriters. Extrasure generally enjoyed 2-3 months' credit with underwriters.

8. In mid-1999 Citygate was trading as a Lloyd's insurance broker. As part of its business, it had a "warehousing" arrangement with a company called

Sloan Mason. In effect, the employees of Sloan Mason were seen by the outside world as employees of Citygate. They were required to do business in the name of Citygate. Accordingly, when Sloan Mason earned any premiums, they would be paid direct to Citygate, and it was Citygate that would pay the underwriters. The principal underwriter in this arrangement was an American company called United Capitol - which was the ultimate recipient of at least the major part of the £200,000 transferred from Extrasure on the 17th August 1999. One of the features of Sloan Mason's American business was that, if the underwriter did not receive the premium within 30 days of the policy incepting, he would send a notice of cancellation direct to the insured.

9. At that stage, in mid-1999, both Extrasure and Citygate were wholly-owned subsidiaries of Inbro Holdings. Mr Scattergood held 51% if the issued share capital of Inbro Holdings, the other shares being distributed among other directors and former directors. Inbro Holdings was not a trading company. Instead, it provided administrative services to its trading subsidiaries, paying the salaries of staff and other outgoings. I understand that there were a number of subsidiaries other than Extrasure and Citygate, but that they were either dormant or generated minimal income. They are accordingly irrelevant for the purposes of this dispute, and I shall ignore them.

10. The only other company that needs to be mentioned at this stage is Sheldrake Management Services Limited ("Sheldrake"), which was a subsidiary of Extrasure.

(c) The *dramatis personae*:

11. David Richard Law ("Mr Law") worked for Extrasure for about 23 years. He was the Managing Director between 1992 and 1996 (when Inbro Holdings acquired the company). He then returned as Managing Director again between 1998 and his retirement in June 2000. He was accordingly the Managing Director when the £200,000 was transferred from Extrasure to Inbro Holdings in August 1999. He was not a director of either Inbro Holdings or of Citygate. He was an entirely honest and conscientious witness.

12. Rolf Tidman ("Mr Tidman") was the Chairman and company Secretary of Inbro Holdings and Citygate until July 1999. He was also a director of Extrasure until July 1999. He did not give evidence.

13. Jayne Bayley ("Ms Bayley") was the Finance Director of Inbro Holdings, Extrasure and Citygate until July 1999. She did not give evidence.

14. Bryan James Pelham Rider ("Mr Rider") was a director of Citygate from April 1990 until its liquidation in September 1999. He became Chairman in May 1999, following the sale of much of Citygate's business to Coyle Hamilton. He was also a director of Inbro Holdings from October 1993 until its liquidation in February 2000. He was not involved in Extrasure. The Claimants served a witness statement from him, but then changed their mind and decided not to call him. Instead, the Defendants applied for permission, which I granted during the trial, to rely on that statement pursuant to CPR rule 32.5(5). Accordingly, I have had the benefit of reading Mr Rider's unsworn witness statement, without seeing him tested by cross-examination.

15. Geoffrey Norman Sloan ("Mr Sloan") was a director of a company trading as Sloan Mason & Partners. It was this business that had entered into a "warehousing" agreement with Citygate. He was an entirely clear and honest witness.

16. Carl Steven Carter ("Mr Carter") was the sales and marketing director of Extrasure for 18 months until about March 1999. He was not with the company when the £200,000 was paid, and his evidence was confined to the state of the inter-company debt between Extrasure and Inbro Holdings in January 1999. He was an entirely honest witness, but his evidence was not directly relevant.

17. Michael John Patston ("Mr Patston") was an insurance broker with Citygate from 1997 until its liquidation in September 1999. He then transferred to Extrasure. Since October 2000, he has been employed by Bennett Gould (a Lloyd's broker now owned by Trans Continental). He was an entirely honest witness, but his evidence was largely hearsay, and added little to the overall picture. The only additional piece of evidence he gave was that the cheque from Citygate to cover his expenses for August 1999 bounced, and this was said by the Claimants to be further evidence of Citygate's financial problems at the time.

18. Mr Scattergood was a director of Extrasure from the 27th May 1999 until the 14th March 2000. He was also a director of Inbro Holdings until 1995. He understood that he had been reappointed as a director of Inbro Holdings in May 1999, but something appears to have gone wrong with the formalities, and his appointment was not recorded at Companies House. Nevertheless, it is common ground that he acted as a *de facto* director of Inbro Holdings from May 1999 until its liquidation in February 2000. He was not a director of Citygate, but he attended its board meetings. He gave evidence at the trial.

19. Mr Beauclair is a chartered accountant. He was a director of Extrasure either from the 27th May or the 3rd June 1999 (it matters not which) until the 19th January 2000. During that period, he acted as the Finance Director. He was also a director of Inbro Holdings and of Citygate from the 9th July 1999, and acted as Finance Director for those companies too. He stopped working for the group in November 1999, having been offered a position elsewhere. He gave evidence at the trial.

20. Geoffrey Boardman ("Mr Boardman") is a chartered accountant. He was, in August 1999, a partner in Macnair Mason. Among his many other clients, he was advising the Defendants in relation to their plan to develop an insurance broking group. The corporate vehicle was Trans Continental (then known as Moneyguard Limited). Their intention was for Moneyguard to acquire Extrasure, Citygate, another Lloyd's broker called Bennett Gould, and SBR Insurance Services Limited ("SBR"). The plan was then to wind down Citygate's business, as there was (in the Defendants' opinion) no point in having two Lloyd's brokers in the same group. Mr Boardman gave evidence for the Defendants at the trial.

21. Paul Vincent ("Mr Vincent") is a director of both the Claimants. He was appointed as a director of Extrasure on the 14th January 2000. His witness statement contained a considerable amount of irrelevant evidence which appeared to have been included in order to discredit Mr Scattergood. He made no attempt to defend the relevance of this material in giving oral testimony. I derived no assistance from it, and I have no hesitation in disregarding allegations which are unconnected with the issues in this action. Furthermore, in giving oral evidence, Mr Vincent evinced a clear personal animosity towards Mr Scattergood, whom he regards as a fraudster. As a result, Mr Vincent was sometimes more belligerent than he was careful in his evidence.

22. Adrian Gyde ("Mr Gyde") became a director of Extrasure and of Trans Continental on the 14th March 2000. He acts as Finance Director, and is also the company Secretary. He has known Mr Vincent for some considerable time. He also gave evidence for the Claimants.

(2) THE FACTS

(a) Inter-company debts:

23. There were (at least until June 1999) two elements in the financial accounting between Inbro Holdings and Extrasure. First, there was a "loan account", and secondly there was an "inter-company balance".

24. The “loan account” had been inherited from the previous owners of Extrasure, Europeiska Insurance Services Group Limited (“Europeiska”). While it was owned by Europeiska, Extrasure had run up an inter-company debt of about £150,000, which Inbro Holdings agreed to take over when it acquired Extrasure in 1996. Also at completion, Inbro Holdings agreed to repay a separate debt owed to Europeiska of £16,312. Extrasure’s nominal ledger thereafter reflected an “Inbro Holdings Ltd Loan a/c” in the sum of £166,312, the balance on which did not move between October 1996 and the 30th June 1999.

25. Extrasure’s audited accounts for the year ended the 30th June 1998 (which were signed on the 18th November 1998, and were the most recent audited accounts available on the 17th August 1999 - the next year’s accounts not being signed until the 26th April 2000) showed in Note 9 the sum of £166,312 as an “amount owed to parent undertaking”. This debt was recorded under the heading “Amounts falling due within one year”. The reason why this sum was so described is that no express contractual terms bad been agreed for its repayment. Mr Law explained (and I accept) that there was nothing more formal than an “understanding” that the money would not be demanded by Inbro Holdings until Extrasure could afford to pay. For accounting purposes, it therefore had to be reflected in the accounts as an amount falling due within a year. Nevertheless, the fact that the “loan” was intended (both by Inbro Holdings and by Extrasure) to be a long-term arrangement in a fixed amount meant that it was necessary to record it separately in the company’s books and accounts from the “inter-company balance”.

26. The “inter-company balance” was a running account that fluctuated from day to day. It arose because of the way in which the parent company would discharge group administrative expenses (such as salaries), while the trading subsidiaries would pass up spare cash to the parent company, supposedly retaining what they needed in order to pay underwriters. However, the transfers of funds from Extrasure to its parent company were not calculated on a scientific basis, nor were they made in fixed amounts or at regular intervals. Instead, lump sum transfers would be made on an *ad hoc* basis. Certainly in the period up to July 1999, while Ms Bayley was the Finance Director, these payments were often dictated by the financial exigencies of Inbro Holdings, rather than by any genuine assessment of Extrasure’s liability in respect of management charges. As a result, Extrasure would sometimes “overpay”, in the sense that more money would be transferred to Inbro Holdings than was necessary to discharge any outstanding management charges. This would throw up a debt on the inter-company balance owed by Inbro Holdings to Extrasure. If, on the other hand, management charges exceeded the amounts transferred from Extrasure at any given moment, then a debt would be shown on the “inter-company balance” owed by it to Inbro Holdings. Mr Law explained (and I accept) that, until the 17th August 1999, the largest single payments made by Extrasure to Inbro Holdings were in the sum of £50,000 each.

27. Partly as a result of the occasional “overpayments” by Extrasure, it was not always in a position to meet its liabilities to underwriters when they fell due. This was referred to in evidence as the “underwriters’ deficit”. Partly as a result, and possibly also as a result of the “loan account”, Inbro Holdings was accustomed to providing Extrasure with an annual letter stating that it “will make available to [Extrasure] sufficient funds to enable the company to continue for at least 12 months”. Letters containing these words were provided on the 2nd December 1997, and again on the 3rd November 1998. This was presumably done in order to persuade the auditors of Extrasure to sign an unqualified audit report in respect of accounts that were prepared on a going concern basis. The comfort letters were reflected in the audited accounts for the year ended the 30th June 1998 in a statement in Note 1(a), to the effect that the directors of Inbro Holdings had given written confirmation of their intention to continue to support Extrasure as a going concern for the foreseeable future.

(b) Events up to August 1999:

28. Mr Scattergood had been a significant shareholder in Inbro Holdings for some time prior to 1999. He had been a director until early 1995, but he then left as a result of a shareholder dispute. That dispute was in due course resolved on terms that made him the majority shareholder in Inbro Holdings. As a result, in about early May 1999 he returned to the group. He became a director of Extrasure, and he acted as a director of Inbro Holdings (although there appeared to be a defect in his appointment, the details of which are immaterial). He did not become a director of Citygate, but he worked for the company.

29. Mr Scattergood’s evidence (which I accept) was that, from the time of his return to Inbro Holdings in May 1999, Mr Beauclair and Mr Rider had been working on the plan to form a new insurance group under Moneyguard (now Trans Continental). They had also been working on Citygate’s financial forecasts.

30. Also, since late 1998, Citygate had been negotiating the sale of its marine and nonmarine business to Coyle Hamilton. The sale was completed in May 1999. As a result, Citygate parted with about two-thirds of its business. A considerable proportion of its staff also transferred to Coyle Hamilton at that time.

31. Whenever a Lloyd’s broker agrees a significant sale, the Brokers Department conducts an audit. In March 1999, PricewaterhouseCoopers (“PwC”) were accordingly instructed to investigate Citygate. On the 3rd June they presented their report to the Brokers Department of Lloyd’s. Although there is a letter from Lloyd’s to Mr Scattergood dated the 27th July 1999 enclosing a copy of the report, Mr Scattergood acknowledged that he had already received a copy some time earlier, and probably shortly after it was provided to Lloyd’s. He thought that the work on which the report was based is likely to have been substantially completed in April. The report made the following observations:

    31.1. Citygate would have made a loss of £250,000 for the year to June 1999 but for the sale in May 1999 of two-thirds of its business to Coyle Hamilton. As a result of the sale, it showed a profit of £100,000.

    31.2. Under the terms of that sale agreement, Citygate would remain dependent on the efforts of Coyle Hamilton to collect brokerage in the sum of £181,000 odd.

    31.3. Following the sale, Citygate adequately met its solvency tests.

    31.4. Citygate expected to make a profit of £86,000 in the year to June 2000, although PwC observed that (i) brokerage income barely exceeded costs, and (ii) Citygate expected income to grow by 38%, which might be difficult to achieve.

    31.5. Although there was downward pressure on premium rates and interest rates, Citygate had nevertheless focused its attention on areas that required less back-office work, and hence should be more profitable.

    31.6.Citygate was generally close to its IBA solvency margin. It bad possible bad debts of £316,000, of which only £86,000 had been provided for. If all of these debts were provided for, its IBA would be insolvent. Furthermore, if Citygate made prudent provision against its doubtful debt, then its IBA would be insolvent. However, if the proceeds of the sale to Coyle Hamilton (which were not due until June 2000) were paid into the IBA, it would create a solvency over margin of £161,000.

    31.7. Citygate was facing claims from three former clients amounting to £5,000,000. Its lawyers advised that there was a good defence, but immediate provision should in any event be made for £50,000 in legal fees.

31.8. There was a large amount of unallocated cash in its IBA which needed to be allocated as a matter of urgency.

31.9. Citygate was owed £571,000 by its parent company, Inbro Holdings, which had a weak balance sheet with net current liabilities of £959,000. Taken together, the group had net current liabilities of £43,000: it was extremely illiquid, and relied on the credit of its creditors to continue trading.

31.10. In order for Inbro Holdings to repay Citygate, it would need to sell Extrasure, because the trading subsidiaries were unable to generate sufficient income for Inbro Holdings to meet its inter-company liabilities.

31.11.However, even if the balance of £571,000 owed by Inbro Holdings to Citygate were written off, Citygate would still remain solvent, as its IBA surplus (subject to the level of bad debt provision) covered its current liabilities.

31.12.There appeared to be a weakness in the management function, especially in the financial control environment. The group did not appear to prepare cash flow forecasts. It was imperative that management should have comprehensive control and reporting of its profitability and cash flows. The financial director had not yet produced the necessary financial information that is necessary to control the company.

32. On the same day, the 3rd June 1999, Citygate held a board meeting which was attended by Mr Scattergood. It was recorded that there was a shortfall in brokerage. A Memo from Ms Bayley the same day (which Mr Scattergood received) stated that no months had been closed since July 1998. It commented that having so many months open was dangerous, because records could get corrupted. Finally, it said that the books did not appear to balance.

33. In early July 1999, Mr Tidman and Ms Bayley were dismissed as employees and removed as directors of Citygate, Extrasure and Inbro Holdings. Mr Beauclair (a former colleague of Mr Scattergood from a previous employer) formally joined as acting Finance Director of all three companies at about the same time, although he had already been working on the financial forecasts for some time.

34. Mr Beauclair found that the books and records were indeed in a mess. He discovered that the IBA ledger had not been reconciled for about 9 months, and that there was significant unallocated cash: the directors' report to the creditors of Citygate in its liquidation put the figure at £4 million in unallocated cash. This was inevitably causing problems in chasing debtors, because the company could not identify the particular transactions in respect of which its debtors owed money. Mr Beauclair spent many days closing unclosed months and debugging routine reports.

35. In his statement to the liquidator of Citygate, Mr Beauclair also explained that he was initially unable to run basic prints, such as bad debts and summary ledger prints. By the end of July he could print off an aged debtor analysis and unallocated cash schedules. However, he said that it was only by early September (i.e. after the transfer of £200,000) that they had a trial balance that "seemed reasonable". By July he was aware that about £400,000 was owed to underwriters. By mid-August, Mr Beauclair said that he considered there was a "hole" in Citygate's IBA.

36. The situation was compounded by the fact that Citygate's accounts manager, Mr Fairbrother, retired at the end of July. Mr Beauclair persuaded a former employee, Mr Picket, to return to Citygate, but he was not due to start until the 23rd August.

37. Largely because of poor accounting records from Inbro Holdings, the position of Extrasure was also unclear. A board meeting was held on the 12th July 1999. The minutes show that no management accounts were available. The board minutes for the following meeting, on the 27th September 1999, show that management accounts could still not have been available.

38. Despite the poor state of the financial records, Mr Beauclair and Mr Scattergood both said in their witness statements that Citygate was trading ahead of budget in May, June and July 1999. However, there is reason to doubt these assertions:

38.1. The profit and loss figures of Citygate for May 1999 (which were received by Mr Scattergood on the 7th July 1999) showed that the budgeted profit had been £120,669, whereas the actual profit was only £11,107. More worryingly, the budgeted write-off of bad debts was £58,771, whereas the actual amount written off was only £10,084. If the full budgeted amount had been written off, there would have been a loss for the month.

38.2. A board meeting of Citygate was held on the 10th August 1999. The minutes show that Mr Beauclair reported that July brokerage was below budget, that he was concerned at the low levels of IBA cash, and that large amounts appeared to be owed to underwriters. Mr Scattergood pointed out in evidence that the minutes also record that Mr Budgen was asked to review July processing, and he claimed that it subsequently emerged that trading was satisfactory for the month: but there is no evidence to suggest that any such review had been completed by the 17th August.

39. In any event, it was clear that Citygate's cash flow was extremely tight. There were repeated requests from Coyle Hamilton for the payment of premiums due to underwriters which had apparently been received by Citygate from the insured before the sale to Coyle Hamilton. Citygate's delay in making payment began to make Coyle Hamilton's position as against the underwriters "untenable", according to a Memo to Mr Scattergood from Gerry Graham, a director of Coyle Hamilton, dated the 26th August 1999.

40. Mr Sloan also explained in evidence that, within a few weeks of Mr Tidman and Ms Bayley being dismissed, he became aware that United Capitol had not been paid a sum of about £200,000 that was due in respect of Sloan Mason's business. He was particularly concerned that this sum should be paid, otherwise there was a risk that the underwriters would cancel the policies they had written, in respect of which the insured had already paid Citygate the premiums. Mr Sloan explained in evidence that he tried to chase the Defendants, but that they were evasive. Matters came to a head on the 17th August 1999.

(c) The amount on the inter-company debt in August 1999:

41. For the reasons I have already given, the "loan account" and the "inter-company balance" were kept separate in the books and accounts of Extrasure, at least until June 1999. However, the two were merged in the nominal ledger by entries dated the 30th June 1999. On that date, the sum of £166,311.99 was credited to the "loan account" (leaving a nil balance) and debited to the "inter-company balance". After allowing for various other movements on the "inter-company balance", this left an overall sum of £104,844.49 owing from Extrasure to Inbro Holdings as at the 30th June.

42. However, it emerged at trial that these entries in Extrasure's nominal ledger were not made until some time later. It is not clear exactly when they were made, but there is circumstantial evidence to suggest that it must have been in the period between the 15th September and the 4th October 1999. Mr Law periodically prepared trial balances. The trial balance for the 31st July 1999 is dated the 15th September 1999. It still shows the "inter-company loan" account as a separate item. However, the trial balance for the 31st August 1999, which was prepared on the

4th October, does not: instead, the "intercompany loan" is shown as nil, and the "inter-company balance" reflects a consolidated figure in line with that in the nominal ledger. (It is also noticeable that the figure of £104,844 is shown as "amounts due to group companies" in the trial balance of Extrasure for the 30th June 1999: surprisingly, that too is dated the 4th October 1999 - i.e. after the date on which the trial balance for July was prepared.) From the dates on the trial balances it would therefore appear, and Mr Law accepted in evidence, that the entries in the nominal ledger dated the 30th June 1999 were in fact written up at some time between the 15th September and the 4th October 1999. They may indeed have been entered up on the 18th September 1999, which was the day on which Mr Law entered up the transfer of £200,000 in Extrasure's cash book. It is therefore clear that these entries in the nominal ledger were not available to the directors on the 18th August.

43. The trial balance for the 31st July shows that there was an "underwriters' deficiency" in Extrasure of about £35,414. This deficiency is arrived at by deducting the figure shown as "RBS IBA" - i.e. cash at bank (£253,987) - from the figure for "companies control" - i.e. the amount due to underwriters (£289,402). The deficiency could have been caused by (i) a failure to collect premiums due from clients, (ii) money having been paid to underwriters in advance or (iii) "overpayments" made by Extrasure to Inbro Holdings.

44. In seeking to demonstrate the true level of the inter-company debt, the Claimants also relied on a Memo dated the 29th January 1999 from Mr Carter to Mr Tidman. This appears to show that Extrasure then owed Inbro Holdings £61,903. However, I can derive very little assistance from that document in assessing the true level of the intercompany debt some 7 months later. Furthermore, in reaching his figure, Mr Carter appears to have deducted from the amount owed by Extrasure to Inbro Holdings a sum of £25,000 owed to Extrasure by one of its own subsidiaries, Sheldrake. I do not understand the logic underlying that approach.

(d) The transfer of 200,000:

45. In August 1999, it is not in dispute that Citygate owed a considerable sum of money to United Capitol. The Defendants explained (and I accept) that the debt was in the sum of about £114,000. United Capitol was putting pressure on Sloan Mason to pay, and Mr Sloan was in turn putting pressure on Citygate. However, Citygate did not have the funds with which to meet these liabilities.

46. Against that background, on the 16th August 1999, Mr Scattergood met with the accountant, Mr Boardman. Mr Beauclair was present for at least part of the meeting. It is not entirely clear what (if anything of significance) he missed.

47. In paragraph 2 of his witness statement, Mr Boardman said that he was instructed by Mr Scattergood and the directors of Moneyguard to advise "them" - suggesting that the advice was personal to the directors. However, in giving oral evidence he candidly admitted that he was not entirely clear where his instructions were coming from, but on balance he considered that he was advising Moneyguard, and not Mr Scattergood personally, or for that matter Extrasure, Inbro Holdings or Citygate.

48. Following the meeting, Mr Boardman summarised his advice in a letter sent to Mr Scattergood's home address, dated the 18th August. Mr Scattergood, Mr Beauclair and Mr Boardman all accept that that letter accurately reflects the tenor of Mr Boardman's oral advice on the 16th August. In summary, what Mr Boardman said was this:

    48.1. The Defendants had told him that there appeared to be a cash flow deficit in Citygate, and that there might also be a "significant amount of uncollectable brokerage".

    48.2. The Defendants' intention was to seek a temporary loan from RBS, but Mr Boardman considered that the bank would not be particularly willing to help.

    48.3. Mr Boardman's oral testimony was that the meeting discussed the possibility of using Extrasure's money as a direct loan to Citygate: by contrast, his letter suggests that the meeting discussed using Extrasure's money as security for a bank loan to Citygate. But whichever route was discussed, the advice was the same. Mr Boardman would not support the idea of using Extrasure's money because, (i) while the directors were still unsure about financial position of Citygate, that might be putting good money after bad and (ii) Lloyd's was against the "pooling" of group assets (i.e. putting group funds into the IBA account of a Lloyd's broker). In oral evidence, Mr Boardman said that this latter point about pooling would not have applied to money transferred by Inbro Holdings to Citygate.

    48.4. Mr Boardman advised that the Defendants should "not put any additional money" into Citygate "either directly or indirectly". He advised that they should "rely upon the funds that have to be in there or are in there already."

    48.5. "Above all" Mr Boardman advised that the Defendants should put a "cordon sanitaire" around Citygate and "at various points, carefully make it clear that no outside support is intended to be made available to that company."

49. In oral evidence, Mr Boardman emphasised that, at the meeting on the 16th August, they did not discuss, and indeed that he could not have known about, the "loan account" owed by Extrasure to Inbro Holdings. If they had discussed it, and if he had known about it, he would have mentioned it in his letter. That evidence makes perfect sense, and I accept it. The possibility of repaying an inter-company debt would have been a logical way of making funds available from Extrasure to Inbro Holdings, and by that route to Citygate. If that possibility had been discussed at the meeting on the 16th August it is, in my view, inconceivable that there would not have been at least some reference to it in Mr Boardman's careful and detailed letter of the 18th August.

50. Oddly, Mr Boardman's oral evidence in this regard was at odds with his witness statement. It is entirely clear from paragraphs 3-8 of that statement that Mr Boardman was there saying that, at the meeting on the 16th August, the "loan account" of about £150,000 was discussed with Mr Scattergood and Mr Beauclair, and that he (Mr Boardman) advised them that, because Extrasure was not subject to Lloyd's or to any other IBA Regulations, it "would be in a position" to make a payment of £200,000 to Inbro Holdings without breaching any "client funds regulation". The witness statement is unambiguous: Mr Boardman was clearly talking about a possible future course of conduct that was discussed at the meeting on the 16th August. However, in cross-examination, he attempted to suggest that his witness statement was not speaking "in terms" about what was discussed at the meeting, but was instead dealing with matters disclosed to him by Mr Scattergood after the 18th August, when the money had already been transferred. This pretence was utterly unsustainable, and it did Mr Boardman no credit.

51. Mr Beauclair's witness statement also said that he discussed the repayment of an intercompany debt with Mr Boardman on the 16th August. Mr Scattergood's witness statement appeared to suggest the same thing, but in oral evidence he said that he could not remember if the inter-company debt was discussed with Mr Boardman. In any event, for the reasons set out above, I prefer Mr Boardman's oral testimony. In my view, it is clear that the "loan account" was not discussed at the meeting on the 16th August.

52. Later on the same day, the Defendants went to see RBS with Mr Rider. The point of their visit was to try and persuade the bank to lend Citygate £300,000. They failed. The bank wrote to Mr Beauclair next day explaining their decision. They said that they recognised the efforts the Defendants had made to improve Citygate's profitability, but they did not have sufficient confidence in the company to make borrowing facilities available. Indeed, they expressly requested that no further items should be presented for payment until the company's IBA position returned to

credit. This was expected to occur when a US Dollar cheque from Coyle Hamilton's bankers had cleared -presumably, within a matter of days. Taken together, Citygate's accounts with RBS showed an overall debit balance of about US $80,000 and an overall credit balance of about £41,000 and Can $13,000 on the 17th August.

53. By this stage, Mr Sloan had been chasing the Defendants for payment of the money due to United Capitol for some time. He said that they were evasive. Finally, on the 17th August, he cornered Mr Beauclair in the kitchen at their office, and told him in no uncertain terms that, if United Capitol was not paid that day, he would report the matter immediately to the Lloyd's Brokers Department. This was an exceptional threat for him to have to make. It would probably have precipitated the immediate appointment of receivers over Citygate, and its consequent liquidation.

54. The Defendants claimed in evidence that they did not know about the problem with United Capitol until a day or so before the 17th August. I find their evidence impossible to accept on this issue. It was quite apparent that Mr Sloan had growing concerns, and he remembered trying to corner the Defendants on more than one occasion over a period of some days. He was a level-headed and honest witness. I do not believe that he would have left the matter to the very last minute. Furthermore, I do not believe that he would have confronted Mr Beauclair in the way he did, or used the colourful language he admitted using, if the matter had not been troubling him for some time, and if he had not already tried unsuccessfully to get the Defendants to make the necessary payment more than once. Mr Scattergood accepted as much in cross-examination. It is also significant that the Defendants arranged to see Mr Boardman and RBS on the previous day - which I take to be a sign of their awareness that Citygate's financial problems were in need of immediate attention. In this regard, I therefore prefer Mr Sloan's evidence, and find that he had been chasing the Defendants for payment to be made by Citygate for some days.

55. Against that background, Mr Scattergood and Mr Beauclair decided that funds should be made available to Citygate from Extrasure, via Inbro Holdings. It is clear from their own evidence (and also from the payment instructions, which both of them signed) that the money being paid out of Extrasure was required and was intended by Mr Scattergood and Mr Beauclair to be used partly in payment of Citygate's liabilities to United Capitol in the sum of about £114,000, and partly to provide it with a float of about £86,000. No arrangements were put in place for these monies to be repaid, either to Inbro Holdings or to Extrasure.

56. Mr Scattergood admitted in cross-examination that he made no attempt to ascertain the level of inter-company indebtedness as between Inbro Holdings and Extrasure on the 17th August. By contrast, Mr Beauclair's evidence was that he did consider the cash book and ledgers of Extrasure on that day, and also that he looked at the trial balance for May 1999. From these, he claimed to have gathered that Extrasure owed Inbro Holdings about £166,000. The Defendants also stated in evidence that they were aware that Extrasure was owed or had received about £30,000 in respect of the sale of certain goodwill in Hong Kong, which they thought was due to Inbro Holdings. They said that they were therefore confident that the inter-company position showed that Extrasure was indebted to its parent company in the sum of £200,000. They claimed to have regarded the transfer as the repayment of that inter-company debt. At the same time, they recognised that, having made the transfer, Extrasure's position was such that it would shortly need a new advance from Inbro Holdings in order to continue trading.

57. At a later stage in this judgment I will have to consider in much greater detail exactly what was in the Defendants' minds on the 17th August. For the purposes of this chronology I will simply record what Mr Beauclair would have seen if he had looked at Extrasure's records:

    57.1. No up-to-date management accounts for Extrasure were available to show the level of management charges due to Inbro Holdings.

    57.2. The trial balance for April 1999 showed (as he admitted in cross-examination) that the net balance owed by Extrasure to Inbro Holdings was only about £32,000.

    57.3. No trial balance for May 1999 has been produced. I am therefore unaware of what it might have shown.

    57.4. The nominal ledger would not have shown the entries made by Mr Law on about the 18th September. However, if Mr Beauclair had worked through the records, and entered up Extrasure's nominal ledger on the l7th August, he would have seen what Mr Law found a month or so later: namely, that Extrasure did not owe Inbro Holdings £150,000, but only £104,844.

    57.5. If he had looked at Extrasure's audited accounts for the year ended the 30th June 1998, he would have seen from Notes 8 and 9 that it then owed Inbro Holdings £166,132, but that it was owed £120,762 by group companies (of which it is agreed that £25,000 was owed by Sheldrake, leaving £95,762 owed to it by Inbro Holdings). On that basis, he would have seen that, in June 1998, Extrasure only owed Inbro Holdings little more than £70,000.

58. As already mentioned, in Mr Beauclair's statement to the liquidator of Citygate, he had said that he thought there was a "hole" in Citygate's IBA. He went on to say in that statement that the decision to transfer £200,000 was taken in order "to give time to establish whether or not [his] fears were unfounded."

59. The decision to transfer £200,000 out of Extrasure's account was taken by the Defendants without reference to Mr Law, the Managing Director. He worked part time, and he was not in the office that day. Although he had almost always been involved in all previous decisions to transfer money from Extrasure to Inbro Holdings, and although the sum in question was 4 times larger than any other payment that had ever been made before, the Defendants made no attempt to contact Mr Law by phone or otherwise before instructing RBS to make the transfer on that day.

60. The next day, Mr Law was back at work. The Defendants took him out for coffee, and told him about the transfer. He was disappointed, but philosophical. He explained in his evidence that, if he had been in the office on the 17th August, he would have done everything he could to stop the transfer. If the Defendants had put it through against his express opposition, he said that he would have resigned on the spot. As it was, he only learned about it after the event. He thought this was the "end of the line" for Extrasure, and he did not believe it would recover. However, he had been with the company for about 23 years, and he did not want to see it fail. Furthermore, the Defendants told him that they would "repay" the "loan" (Mr Beauclair's own words in paragraphs 11 and 13 of his witness statement, and Mr Scattergood's words in paragraph 9 of his statement) within a maximum of 2 weeks. Mr Scattergood repeated in oral evidence that he told Mr Law that the money would be "repaid" (again, his word) within 30 days. For those reasons, Mr Law decided to stay and try to help save the company. Having only found out about the transfer after the event, and having been assured that the money would be returned soon, he did not consider that it was something over which he needed to resign.

61. Mr Law's evidence was (and I accept) that, on the 18th August, the Defendants may have told him about the problem with Sloan Mason and United Capitol, but that they did not attempt to justify the transfer to Inbro Holdings on the basis that Extrasure was repaying any inter-company debt.

62. Also on the 18th August 1999, Mr Rider wrote to Lloyd's referring to Mr Picket's imminent return to Citygate. He said that Mr Picket's brief would be to "establish the 'true' bad debt provision". The obvious inference is that, on the 18th August, the directors of Citygate did not know what the true bad debt position was.

63. After the 18th August, Mr Law chased the Defendants for repayment of the £200,000 to Extrasure almost every week. He explained in evidence that they kept giving him assurances that the money would be paid. However, no money appeared in Extrasure's bank account.

64. On the 13th September 1999, Citygate wrote to Lloyd's Brokers Department drawing attention to the state of its accounting records. The letter was signed by Mr Rider. In cross-examination, Mr Beauclair initially denied that he had written the letter. When his attention was drawn to a fax cover sheet dated the 9th September from himself to Mr Boardman, enclosing a draft of the letter, he was constrained to admit that he had typed it, but he still insisted that he had not composed it. He was evasive on the question whether he disagreed with any of its contents. In my view, this was neither credible nor creditable evidence from Mr Beauclair. He is a chartered accountant, and he was the Finance Director of Citygate at the time. The letter with which we are concerned was the letter that precipitated Lloyd's decision to crystallise the trust deed and appoint receivers over Citygate. The day after the letter was sent, the company went into insolvent liquidation. In my view, it is quite impossible to believe that Mr Beauclair was not intimately involved in drafting a letter of such evident importance, and I find that he must have agreed with its contents at the time, or he would not have allowed it to be sent.

65. The letter said that, due to large amounts of unallocated cash, "it is virtually impossible to establish the true financial position" of Citygate.

66. Once Citygate had gone into liquidation, it was apparent to Mr Law that Extrasure was not going to be repaid from that quarter. Accordingly, he was keen to ensure that Inbro Holdings would make good the money. With this in mind, he had a formal meeting with the Defendants and Mr Rider on the 16th September 1999, at which they repeated their assurance that Extrasure would be repaid. Following that meeting, Mr Law drafted a letter to Mr Scattergood on Extrasure writing paper, dated the 20th September 1999. Mr Scattergood, Mr Beauclair and Mr Rider each signed the letter by way of confirming its contents. The letter contained the following statement:

> "I also appreciate your assurance that funds will shortly be available to reduce the inter-company debt due by [Inbro Holdings] to Extrasure."

(e) The negotiations with Mr Vincent:

67. In about October 1999, Mr Vincent bumped into Mr Scattergood in the street. They had coffee and discussed the Defendants' plan to put together an insurance group. Mr Scattergood explained the Defendants' plan to acquire another Lloyd's broker, Bennett Gould. Their plan was for the parent company to be Moneyguard (now Trans Continental). The other subsidiaries were intended to be Extrasure, Citygate, and SBR.

68. Once Mr Vincent became involved, the idea was to introduce Moneyguard Holdings Limited as the ultimate parent company. However, the negotiations dragged on, and in due course Mr Beauclair became frustrated at the length of time it was taking to close the deal. He departed in early November 1999, because he had received an attractive offer of work elsewhere. He remained as a director for a few weeks longer, but he had stopped working for the group from the 9th November.

69. In the course of the negotiations between Mr Vincent and Mr Scattergood in the latter part of 1999, Mr Vincent said in evidence that Mr Scattergood drew to his attention the fact that various inter-company transfers had been effected between Extrasure and Inbro Holdings. This evidence forms the basis of the second claim in the action. However, Mr Vincent's testimony, even in chief, was slightly confusing. He said in paragraph 48 of his witness statement that Mr Scattergood "left me with the clear *impression* [emphasis added] that the inter company transactions that [sic] had been authorised by both Tidman/Bayley." However, later in the same paragraph he said that he specifically asked Mr Scattergood if he had been involved in the inter-company transactions, and that Mr Scattergood had said "no". On this basis, it is alleged that Mr Scattergood (though not Mr Beauclair) made a deliberate misrepresentation.

70. In answer, both Mr Scattergood and Mr Beauclair said in evidence that they explained "the situation with regard to the £200,000" - and in particular their own involvement in authorising the transfer - very fully at their first meeting with Mr Vincent in October 1999. They both insisted that the same matters were covered again at a meeting between them and Mr Vincent on the 11th November 1999. The Defendants were particularly certain about the content of the discussions at this meeting, because Mr Beauclair had only just left the company for his new employment, and he was irritated at being called back so soon to discuss something he and Mr Scattergood had already explained. I will return to the question of whose evidence I prefer when dealing with the second claim.

71. In early 2000, Mr Gyde became involved in the discussions with Mr Vincent and Mr Scattergood. In due course, Moneyguard Holdings acquired Moneyguard on the 12th January 2000. Also, in or about the second week of January 2000, Moneyguard completed the acquisition of all the issued share capital of Extrasure from Inbro Holdings. The written purchase agreement, signed by Mr Scattergood on behalf of Inbro Holdings, and by Mr Beauclair on behalf of Moneyguard, is actually dated the 14th October 1999. However, in cross-examination Mr Scattergood did not pretend that the agreement was actually written or signed on that day. He acknowledged that the agreement was both drafted by solicitors Bryant Hamilton, and signed by the parties, in early January 2000. In my view, that is plainly what happened. The board minutes of Extrasure dated the 28th October 1999 and the 4th January 2000 (the authenticity of which there is no reason to doubt, and the content of which Mr Law confirmed in his witness statement) both make clear that the company had not been sold by Inbro Holdings on either of those dates. Also, Mr Scattergood signed certain Heads of Agreement dated the 24th November 1999 with Mr Vincent: clause 16 makes clear that Inbro Holdings still owned Extrasure on that day. Furthermore, there is a letter from Bryant Hamilton to Moneyguard dated the 5th January 2000 which says in terms that they were instructed the day before to draft a purchase agreement. There is also an early draft of the purchase agreement which has manuscript annotations on it dated the 7th January 2000. Moreover, Mr Law explained that he had been asked, in or about January 2000, to sign a copy of the agreement on behalf of Extrasure, and had refused because it was back-dated, and because he had already signed a correctly dated copy. It appears to be common ground that the agreement was completed on the 14th January 2000. In the circumstances, I am left in no doubt that the agreement was in fact created and signed on or about the 14th January 2000.

72. Mr Scattergood said it was the solicitors' idea to back-date the agreement. He explained that they had asked him when the essential terms were agreed. He told them it was in the second week of October 1999, and they said that that was the date the agreement ought to bear. Furthermore, he explained that the reason why the board minutes of Extrasure dated 28th October 1999 and the 4th January 2000 did not refer to any agreement between Inbro Holdings and Moneyguard was that at that stage Mr Law had wanted to sell Extrasure to another purchaser, Mercury International / Noel Group, and that Mr Scattergood did not. As a result, Mr Scattergood says that he practised a deception on Mr Law, by hiding from him the fact that Inbro Holdings had in principle already agreed to sell Extrasure to Moneyguard. I was struck by the casual and unembarrassed manner in which Mr Scattergood acknowledged this deception.

73. Whether or not there was an agreement in principle between Inbro Holdings and Moneyguard in October 1999, Mr Scattergood's conduct in this regard has clearly involved deliberate deception. If there truly was such an agreement, then he knowingly deceived his fellow director, Mr Law. If there was no such agreement, then he has been attempting to deceive the court. In either event, the back-dating of the agreement is not in doubt. In the absence of any corroborative evidence about Bryant Hamilton, I can make no finding as to their participation. However, it is perfectly clear that Mr Scattergood knowingly and intentionally signed an agreement which bore a date other than that on which he signed it. From the witness statements of Mr Vincent and Mr Gyde, it would also appear that Mr Scattergood attempted to deceive the Employment

Tribunal in this regard. They both stated that, in March 2001, he had insisted on oath before the Tribunal that the purchase agreement "had been signed and was concluded" in October 1999. Neither of them was cross-examined on that assertion, which I take to be an admission that that was indeed Mr Scattergood' s evidence before the Tribunal.

74. For his part, Mr Beauclair appeared to have little involvement in drafting the agreement, and no recollection of signing it. Nevertheless, the document was very clearly dated the 14th October 1999 in large, bold print, both on the first page and on the execution page, immediately above his signature. He did not pretend that he had not noticed the date when he signed it. Accordingly, I find that Mr Beauclair too knowingly participated in a deception in relation to the back-dating.

75. The purchase consideration payable under the agreement was £20,000, plus 40% of 12 months' gross brokerage or commission income receivable by Extrasure from all sources during the period from the 30th June 2000 to the 30th June 2002, on the basis of its audited accounts, less the amount of any net asset deficiency as certified by the auditors as at the 31st December 1999. The payment of £200,000 on the 17th August 1999 had the effect of increasing the net asset deficiency and thereby decreasing the amount of earn-out consideration payable by Moneyguard.

76. The purchase agreement also refers expressly at paragraph 10.1.1 of Schedule 6 to the repayment by Extrasure to Inbro Holdings of a loan of £150,000. (It is common ground that the reference in that paragraph to "Purchaser" is a drafting error, and that it plainly intended to refer to "Vendor".)

77. In early 2000, Independent Insurance began to express concerns about continuing their business relationship with Extrasure. In particular, they expressed a certain hostility towards Mr Scattergood. A meeting was arranged for the 18th February 2000 between Independent Insurance, Mr Vincent, Mr Law and Mr Patston. The hostility Independent Insurance felt towards Mr Scattergood was evident at that meeting. As a result, he appears to have agreed to step down as a director and as an employee of Extrasure.

78. After the meeting on the 18th February 2000, it became increasingly clear that good relations between Mr Vincent and Mr Scattergood would not survive indefinitely. The time at which, and the basis upon which, Mr Scattergood ceased to be a director or employee of Extrasure, Trans Continental or Trans Continental Holdings are not entirely clear: for example, Mr Vincent disarmingly states in paragraph 30 of his witness statement the "Alan Scattergood was formally resigned as a director of Extrasure with effect from 14 March 2000." This wording is obviously not an editorial error, because exactly the same formula is also used to describe the departure of Mr Rider and another director in paragraph 31 of the same statement. However, the details of Mr Scattergood's departure are not material, and I will not attempt to sort out exactly what was agreed, or when.

79. Meanwhile, shortly after Mr Gyde had joined Trans Continental and Extrasure in March 2000, he started going through its books and records. He soon identified the transfer of £200,000 which had been made on the 17th August 1999, and drew it to Mr Vincent's attention. He tried persuading Mr Vincent to look into the matter, but apparently Mr Vincent did not appear particularly concerned about the transfer at that stage. Mr Gyde admitted that Mr Vincent only became interested in the transfer of £200,000 after Mr Scattergood had left Trans Continental and had commenced proceedings against it in the Employment Tribunal.

80. Mr Law also explained in evidence that he had told Mr Vincent about the £200,000 transfer, and in particular about the Defendants' responsibility for the transfer, shortly after Mr Vincent became involved in Moneyguard. Mr Law was unclear about the exact date, but it appears likely to have been in early 2000, possibly even before Mr Gyde was making similar comments to Mr Vincent. Mr Law said that Mr Vincent seemed neither angry nor surprised at the disclosure.

81. Mr Gyde explained that he had also seen a copy of the purchase agreement between Inbro Holdings and Moneyguard (which referred at paragraph 10.1.1 of Schedule 6 to the repayment of a loan in the sum of £150,000) by early May 2000.

82. It became clear in the course of correspondence between May and August 2000 that the terms on which Mr Scattergood had left, or was prepared to leave, the Trans Continental group were in dispute. In due course, he brought separate proceedings before the Employment Tribunal, with which I am not directly concerned. However, there is one issue in those proceedings which hangs on the court's findings in this case - namely, whether Mr Scattergood did or did not make the representation which forms the basis of the second claim in this action.

83. In the course of the dispute between Mr Scattergood and the Claimants, a meeting was arranged on the 31st August 2000 between Mr Beauclair, Mr Vincent and Mr Gyde. Mr Beauclair explained (he says, again) the circumstances in which the £200,000 had been transferred. Both Mr Vincent and Mr Gyde gave detailed accounts of what was said at that meeting in their witness statements, including certain alleged admissions by Mr Beauclair. However, Mr Beauclair was not cross-examined on what he said at the time. Furthermore, given the wealth of other material that is available dating from August 1999, rather than August 2000, it is unnecessary for me to make any findings in relation to what was said at that meeting.

84. There is one last meeting to which I should refer. On the 19th December 2000, Mr Vincent met with Mr Beauclair. Mr Vincent insisted in evidence that the meeting was expressly agreed to be "without prejudice". He also refused to accept that the note was an entirely accurate record of the meeting. Mr Beauclair disagreed on both counts. In the event, Mr Beauclair's note of the meeting was put to Mr Vincent in cross-examination without his objection. For that reason, I find it unnecessary to decide whether the meeting was "without prejudice" or not. It is also unnecessary to decide whether the note was an entirely accurate record of what was said. The Defendants' only point in referring to it was to suggest that Mr Vincent had simply raised the threat of suing the Defendants for £200,000 as a negotiating ploy to persuade Mr Scattergood to drop his employment claim. But there would be little force in this point, even if it were true. Either the company's claim for £200,000 is good in law, or it is not: the personal motives of Mr Vincent, and the circumstances in which the claim was first threatened, are irrelevant.

85. It is a matter of record that the first time the Claimants made an admittedly open reference to a claim against the Defendants for the £200,000 was in the letters before action dated the 7th February 2001. That was apparently just a month before the anticipated hearing in the Employment Tribunal. Even on the Claimants' own evidence, it was also about a year after Mr Vincent had first learned about the £200,000 transfer from Mr Law and Mr Gyde.

86. Finally, I should mention that there is no documentary evidence to show that Extrasure has proved as a creditor for £200,000 in the liquidation of Inbro Holdings.

(3) THE FIRST CLAIM

(a) The law:

87. It is trite law that a director owes to his company a fiduciary duty to exercise his powers (i) in what he (not the court) honestly believes to be the company's best interests, and (ii) for the proper purposes for which those powers have been conferred on him. Mere incompetence is not a

breach of fiduciary duty: it might give rise to a claim for breach of a tortious or contractual duty of care, but the claim in this case was based entirely on alleged breaches of fiduciary duty.

88. The Claimants sought to argue that a director is also in breach of his fiduciary duty if he honestly, but unreasonably and mistakenly, believes that he is pursuing the company's best interests. This argument was founded on a single remark of Richard Field QC (sitting as a Deputy High Court Judge) in Re Pantone 485 Limited [2002] 1 BCLC 266 at paragraph 46. In that passage, the judge observed that it was not a breach of fiduciary duty for a director of company A to advance monies for the benefit of a related company B, if the director "honestly and reasonably" believed that company B would repay the monies so advanced. On the basis of this formulation, Mr Nicholls submitted that it *would* be a breach of fiduciary duty if the director's belief, albeit honestly held, had no reasonable basis in fact. He submitted that, if the law were otherwise, a director would be immune to suit for crass incompetence: in other words, his fiduciary duties would be less demanding that any common law duty of care.

89. I reject that proposition. Fiduciary duties are not less onerous than the common law duty of care: they are of a different quality. Fiduciary duties are concerned with concepts of honesty and loyalty, not with competence. In my view, the law draws a clear distinction between fiduciary duties and other duties that may be owed by a person in a fiduciary position. A fiduciary may also owe tortious and contractual duties to the *cestui que trust*: but that does not mean that those duties are fiduciary duties. Bearing all that in mind, I find nothing surprising in the proposition that crass incompetence might give rise to a claim for breach of a duty of care, or for breach of contract, but not for a breach of fiduciary duty.

90. Furthermore, I do not consider that the judge's remarks in Pantone 485 can support the proposition for which Mr Nicholls relies on them. What the judge was dealing with was a question of onus - namely, whether a claimant in such a situation has to prove that the money has *not* been repaid by company B, or whether the director has to prove that the money *has* been repaid. In my view, the judge was not seeking to address any fundamental question of substance as to the scope of a director's fiduciary duty - namely, whether he is in breach of that duty if he acts on an honest, but unreasonable and mistaken, view. In any event, if (contrary to my understanding) that is what the Judge was saying, then he was flying in the face of a clear line of binding authority running from Smith v. Fawcett [1942] 1 Ch 304 at 306, through Bristol & West Building Society v. Mothew [1998] Ch 1 at 18, to Regentcrest plc [2001] 2 BCLC 81 at l05a-h. Those cases make it perfectly clear that a director's duty is to do what he honestly believes to be in the company's best interests. The fact that his alleged belief was unreasonable may provide evidence that it was not in fact honestly held at the time: but if, having considered all the evidence, it appears that the director did honestly believe that he was acting in the best interests of the company, then he is not in breach of his fiduciary duty merely because that belief appears to the trial judge to be unreasonable, or because his actions happen, in the event, to cause injury to the company.

91.The Claimants also sought to argue that the test of reasonableness was relevant if the directors of a group of companies have entered into some transaction without considering the separate interests of each company in the group. In Charterbridge Corporation Limited v. Lloyds Bank Limited [1970] 1 Ch 62, Pennycuick J considered *obiter* exactly that situation. He rejected the plaintiff's submission that the directors must *ipso facto* be in breach of their fiduciary duties to the various group companies, because he considered that that would produce "absurd results": *ibid* at 74D. Instead, he proposed that the correct test, in the absence of separate consideration, must be 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: *ibid* at 74E-F. Although his remarks were *obiter*, I would respectfully adopt the learned judge's approach in this regard - if in fact no consideration was given to the separate interests of Extrasure by the Defendants.

92. The law relating to proper purposes is clear, and was not in issue. It is unnecessary for a claimant to prove that a director was dishonest, or that he knew he was pursuing a collateral purpose. In that sense, the test is an objective one. It was suggested by the parties that the court must apply a three-part test, but it may be more convenient to add a fourth stage. The court must:

92.1. identify the power whose exercise is in question;

92.2. identify the proper purpose for which that power was delegated to the directors;

92.3. identify the substantial purpose for which the power was in fact exercised; and

92.4. decide whether that purpose was proper.

93. Finally, it is worth noting that the third stage involves a question of fact. It turns on the actual motives of the directors at the time: Re a Company, ex parte Glossop [1988] BCLC 570 at 577f-g.

(b) The parties' arguments in outline:

94. The claim to £200,000 was put essentially on 4 grounds:

94.1. the transfer was not in the best interests of Extrasure;

94.2. the transfer was made for an improper purpose;

94.3. the transfer was *ultra vires* the directors;

94.4. the transfer was in breach of Mr Scattergood's obligation not to put himself in a position of conflict.

95. The latter two formulations caused no presentational problems. However, it is necessary to consider the first two ways in which the Claimants put their case in a little more detail.

96. As to the first way in which the Claimants put their case, it is clear from paragraph 9 of the Particulars of Claim (and from paragraphs 13 and 17 of the Reply to a Part 18 Request) that they simply alleged that the transfer of £200,000 was not in the interests of Extrasure. They did not allege that the Directors had no honest belief that it was in the interests of Extrasure. They simply alleged that it was not, in fact, in the interests of Extrasure. When Mr Nicholls was opening the case, he confirmed that this was indeed the Claimants' position. Relying on his interpretation of Pantone 485, he put his case on the basis that the Defendants had no reasonable basis for believing that it was in the interests of Extrasure to make the transfer. He did not allege that they *did* not believe that it was in that company's interests.

97. Given my understanding of the law, which I have already set out, I would unhesitatingly have rejected that argument. In my view, it is not sufficient for a company to prove that its directors took action which proved to be damaging to the company, unless it can also show that the directors did

not honestly believe that the action was in the best interests of the company. The fact that the directors' belief was unreasonable does not put them in breach of their fiduciary duties, if that belief was honestly held.

98. Turning to the case put by the Defendants, it is clear from paragraphs 11(1) and 13 of their Defence that their only pleaded response to both of the first two ways in which the Claimants put their case was that it was in the interests of Extrasure to make the transfer because it had the effect of repaying an inter-company debt owed by Extrasure to Inbro Holdings.

99. Given my understanding of the facts, which I set out below in greater detail, I would unhesitatingly have dismissed that defence to the claim based on improper purpose. In my view, it is perfectly clear that the Defendants' substantial purpose in making the transfer was not to repay any debt owed by Extrasure to Inbro Holdings. I have reached that conclusion because I do not consider that they even thought about the inter-company debt on the 17th August. On that basis, the claim based on improper purpose would undoubtedly have succeeded.

100. However, in the various witness statements, and more particularly in the course of the trial, there was inevitably some movement from the formal positions adopted by each of the parties in their pleadings. The Defendants were cross-examined at length and in detail about what they actually thought, at the time of the transfer, about Citygate's ability to repay - which was an issue that did not strictly arise on the Claimants' pleaded case. Mr Nicholls submitted in closing that the Defendants did not believe that the transfer was in Extrasure's best interests by reference to any repayment of the intercompany debt. For their part, the Defendants advanced an argument that was not pleaded either (although its birth was heralded in paragraph 15(i) of their Reply to a Part 18 Request), namely that they believed the transfer was in the interests of Extrasure because it had the effect of saving Citygate, thereby saving Inbro Holdings, and thereby helping to preserve the survival of Extrasure itself.

101. Neither party objected to the other side's case being developed in these ways at trial. Furthermore, neither side appeared to be disadvantaged in the way they responded to the other side's case. In the circumstances, it would be doing a disservice to both sides if I failed to deal with the issues as they actually emerged at trial.

(c) The issues:

102. Against that background, it appears that the following issues need to be determined:

102.1. Did the Defendants in fact consider that the transfer was in the best interests of Extrasure because it had the effect of discharging a debt owed to Inbro Holdings?

102.2. Did the Defendants in fact consider that the transfer was in the best interests of Holdings because it was calculated to ensure the group's survival, including that of Extrasure itself?

102.3. If the Defendants gave no independent consideration to the question whether the transfer was in Extrasure's interests, would a reasonable director in their position have reached that conclusion?

102.4. Was the transfer made for an improper purpose?

102.5. Was the transfer *ultra vires* the directors?

102.6.Was the transfer a breach of Mr Scattergood's duty not to put himself in a position of conflict?

102.7. Was the transfer ratified by Inbro Holdings?

102.8. Did the Defendants act honestly and reasonably, and ought they fairly to be excused?

102.9. Did Extrasure suffer any recoverable loss as a result of the transfer?

102.10. If so, has Extrasure failed to mitigate that loss?

Issue (1): Did the Defendants think that Extrasure was repaying a debt?

103. The Defendants allege that the payment of £200,000 by Extrasure to Inbro Holdings was considered by them, on the 17th August 1999, to be in the best interests of Extrasure because (i) as to about £150,000, they regarded it as a repayment of the "loan account" and (ii) as to the balance, they regarded it as the payment of money owed to Inbro Holdings which was received by Extrasure in relation to the sale of some goodwill in the Far East. I have no hesitation at all in rejecting the Defendants' evidence in this regard.

104. I will deal first with the suggestion that their intention on the 17th August 1999 was to repay an inter-company loan of £150,000:

104.1. It is clear from Mr Boardman's evidence that this potential justification for transferring money from Extrasure to Inbro Holdings was not discussed with him at all on the 16th August. If it had been in the Defendants' minds at the time, they would plainly have wanted to talk it through with their accountant. They did not. The inference is that it was not in their minds on the 16th August.

104.2. If on the 17th August the Defendants had thought that the transfer could be justified as a repayment of the "loan account", then it is inconceivable that they would not have proceeded to investigate the true level of indebtedness. However, Mr Scattergood admitted in cross-examination that he did not attempt to ascertain the true level of the inter-company debt. Equally, I do not believe that Mr Beauclair made any such attempt either. Mr Boardman had no recollection of it: and the evidence that Mr Beauclair would have encountered if he had undertaken such an exercise would not have led him to the conclusion that the balance on the inter-company debt showed that £150,000 was owed by Extrasure to Inbro Holdings.

104.3. On the 18th August 1999, the very day after the transfer, the Defendants did not attempt to justify the transaction to Mr Law on the basis that it represented the repayment of a debt by Extrasure. If the Defendants had had in mind, on the 17th August, an entirely legitimate justification for passing £200,000 up to Extrasure's parent company, it is inconceivable that they would not have wanted to put that explanation to the company's Managing Director the very next day. They did not. The inference is that no such thought was in their minds on the 17th or the 18th August.

104.4. The Defendants both admitted in evidence that they had reassured Mr Law that Citygate would "repay" the "loan" within a matter of days or weeks. They could not possibly have used this language if they had thought that the transfer of funds to Inbro Holdings had the

effect of repaying a debt due from Extrasure. In my view, the inference is that the Defendants had not thought of justifying the transfer by reference to the "loan account" on the 18th August.

104.5. If the Defendants regarded the transfer on the 17th August as a repayment by Extrasure of a debt owed to Inbro Holdings, it is impossible to see why they would have signed the letter from Mr Law dated the 20th September, referring to their assurances about reducing the debt owed by Inbro Holdings to Extrasure. Mr Beauclair shrugged and said that he signed the letter "for an easy life". Mr Scattergood had no explanation as to why he signed the letter when, on his version of events, it was plainly inaccurate. In my view, the only credible explanation is that the letter correctly reflected the Defendants' understanding as at the 20th September - namely that, as a result of the transfer of £200,000, Inbro Holdings was indebted to Extrasure. They had not then hit upon the idea of justifying the transfer by reference to a repayment of any "loan account" between the two companies.

104.6. Mr Law explained in his evidence that, sometime in October 1999, after he had returned from a holiday, Mr Scattergood came to him and asked if he could help try to justify the transfer. Mr Law said that he suggested that it might be characterised as a repayment of the "loan account". He said that he was not particularly proud of the suggestion, and that he did not consider that that was what had happened - but that is what he said to Mr Scattergood, in an effort to assist. In my view, this was compelling evidence. There was absolutely no reason why Mr Law should invent a piece of evidence that did not reflect well on him: quite the reverse. But, to do him credit, he was entirely frank about it. He admitted that the suggestion about justifying the transfer in this way came from him. He also admitted that, although he was not comfortable with it, if he had been presented with accounts for Extrasure that reflected the transaction on that basis, he probably would have signed them.

104.7. As has been seen, Inbro Holdings had passed a board resolution to provide support to Extrasure at least until the 3rd November 1999. Accordingly, it had agreed not to call in any outstanding balance on the "loan account" in that period. By causing Extrasure to transfer £200,000 to Inbro Holdings purportedly by way of repaying the debt, the Defendants would therefore have been causing it to repay a debt that was not due and had not been demanded. Furthermore, the Defendants could not have believed that, on the 17th August, they were acting on behalf of Inbro Holdings in demanding immediate repayment, because although Mr Beauclair may have been a *de jure* director and Mr Scattergood was at least a *de facto* director, there was plainly no attempt to convene a board meeting of Inbro Holdings, and neither of the other directors (Mr Rider and a Mr Fox) were even aware of the transaction. In the circumstances, the Defendants acting together could not conceivably have thought (and, I find, did not think) that they were overriding the previous board resolution of Inbro Holdings.

104.8. Finally, in assessing the Defendants' credibility on this issue, I must take into account their performance in relation to back-dating the share purchase agreement between Inbro Holdings and Moneyguard in January 2000. That incident betrays an alarming ability on their part to re-write history in a manner that suits them: it plainly suited them in early 2000 to create the impression that Extrasure was not in fact sold by Inbro Holdings on the eve of the latter's insolvent liquidation. Furthermore, Mr Scattergood's insistence before the Employment Tribunal that that agreement was signed in October 1999, and his ready admission to the contrary in this trial, displays an even more alarming ability on his part to say on oath whatever happens to suit his purposes, as he sees them.

105. Both sides attempted to rely, to a greater or lesser extent, on various accounting documents created after October 1999 to support their respective arguments. I found little assistance from such documents, created as they were with the benefit of hindsight. I prefer to base my decision on the factors set out above. On that basis, I am satisfied that the Defendants did not think, on the 17th August 1999, that the transfer of £200,000 was in the best interests of Extrasure by reason of the fact that the transfer represented in part the repayment of the "loan account". I take that view because I am entirely satisfied that the Defendants did not even think about the "loan account" on the 17th August 1999.

106. Leaving aside the inter-company debt (which the Defendants said they thought was in the sum of £150,000), their evidence was that they believed that the balance of the £200,000 represented a payment by Extrasure of money due to Inbro Holdings from a transaction in Hong Kong. In my view, this assertion as to their state of mind on the 17th August 1999 is even less plausible. It is common ground that Extrasure sold the goodwill of its trading name in the Far East. It is also common ground that certain payments were made to Extrasure in respect of that sale. In my view, it is perfectly clear that the goodwill, and the payments received in respect of its sale, were assets of Extrasure. I reject entirely the Defendants' attempt to suggest that they thought this was Inbro Holdings's money, and that the transfer of £200,000 represented *pro tanto* a payment due from Extrasure.

106.1. Mr Beauclair was wholly unable to explain why the money should belong to Inbro Holdings. He simply said that Mr Scattergood told him that it did, and he did not apply his mind to the issue. I found this evidence breath-taking, coming as it did from a chartered accountant. It was not improved when Mr Beauclair added that there was a "certain logic" in Mr Scattergood's assertion, given that Inbro Holdings was the parent company. Any businessman, let alone a qualified accountant, knows that each company in a group owns its own assets. If a. subsidiary company sells an asset, the sale proceeds do not belong, and are not payable to, the parent company simply by reason of the relationship of parent and subsidiary. Furthermore, having seen Mr Beauclair in the witness box for an entire day, I formed the clear impression that he was an intelligent and experienced man. I do not accept for one moment that he genuinely believed that the sale proceeds from Hong Kong belonged to Inbro Holdings.

106.2. Similarly, I reject Mr Scattergood's evidence in this regard. Like Mr Beauclair, he could come up with no plausible explanation as to why he might have thought that the sale proceeds belonged to Inbro Holdings, rather than to Extrasure. The most he could say was that the sale by Extrasure of its goodwill in the Far East could not have taken place without the prior approval of Inbro Holdings: but prior approval is a completely different thing from saying that the resultant sale proceeds belong to the parent company, and I believe Mr Scattergood knew that perfectly well.

106.3. It is striking that the alleged repayment of money by reference to the Hong Kong transaction was not mentioned by either of the Defendants to Mr Boardman or to RBS on the 16th August, or to Mr Law on the 18th August.

106.4. If any further proof were needed, then regard has only to be paid to Extrasure's nominal ledger. That shows that only £37,498.69 had been received from the Hong Kong transaction. If, as the Defendants contend, they believed that the "loan account" was in the sum of £150,000, then they would have needed to find a justification for paying a further £50,000 in order to make up the full £200,000, not just £36,498.69. So, even if their explanation about the Hong Kong money were correct, it would not have justified their behaviour. For this reason also, I do not believe that, on the 17th August 1999, they even considered the question whether Extrasure was indebted to Inbro Holdings in relation to the Hong Kong money.

106.5. Finally, and perhaps most importantly, the Defendants' evidence in relation to the Hong Kong payment only makes sense if they had already decided on the 17th August that the balance of the £200,000 represented the repayment of the "loan account". For the reasons

I have already given at some length, I do not consider that any such thought was in their minds on the 17th August, and so there would have been no reason for them to seek to justify the balance of the transfer by reference to the Hong Kong transaction.

107. In the circumstances, I am satisfied that the Defendants did not think, on the 17th August 1999, that Extrasure was repaying the "loan account", or that it was repaying money due to Inbro Holdings from the transaction in Hong Kong. They made the transfer because Citygate needed the money, because Extrasure had the money, and because Mr Sloan had issued an ultimatum.

Issue (2): Did the Defendants think the transfer was needed to save the group?

108. The Defendants' alternative case was that they considered the transfer to be in the best interests of Extrasure because they thought it was necessary to save Citygate, and thereby to save Inbro Holdings and Extrasure itself.

109. On the 31st July 1999, Extrasure's bank account had a credit balance of £254,000. The effect of transferring £200,000 out of that account was to strip Extrasure of virtually all its cash. The result was that, after the 17th August, the company was in exactly the same position as Citygate had been in immediately before the transfer: namely, it had insufficient funds to meet the payments due to underwriters from the premiums it had already received from its clients. Viewed in that light, the transfer was self-evidently not in Extrasure's interests.

110. Furthermore, Inbro Holdings was plainly in no position to repay the £200,000. The PwC report explained that it had net current liabilities of £959,000 in its most recent audited accounts. Furthermore, Extrasure had as recently as the 15th July 1999 transferred £50,000 to Inbro Holdings, and then transferred another £50,000 on the 12th August. Moreover, a file note of a meeting on the 18th August 1999 shows that the Defendants knew that Inbro Holdings was so short of funds that it had to borrow money from Moneyguard in order to pay staff salaries for the month of August. The relevant cheque stub shows that a loan of slightly less than £35,000 had to be made for this purpose. Furthermore, the Defendants candidly admitted that Inbro Holdings would only ever be able to repay the £200,000 to Extrasure if the money could be generated from Citygate.

111. Against that background, the Defendants were frank enough to admit that, with hindsight, the transfer should not have been made. They also admitted that they knew at the time that there was a risk in making the transfer. But they say that they considered it was an acceptable risk. Their argument in this regard therefore depends on two elements:

111.1. First, that they believed it was in Extrasure's interests that Citygate should survive.

111.2. Secondly, that they believed there was a reasonable prospect that Citygate would survive if £200,000 was paid to it on the 17th August 1999, and that it would be able to repay that amount within the foreseeable future.

112. As to the first issue, it appears to be common ground that, if Citygate was forced into liquidation, then Inbro Holdings would similarly be forced into liquidation: it owed a very considerable sum of money to Citygate, which it could not afford to pay. In the event, that is what happened, although Inbro Holdings managed to defer the inevitable until the 16th February 2000, some 5 months after Citygate went into liquidation. On that basis, the argument advanced on behalf of the Defendants was that, if Inbro Holdings went into liquidation, then Extrasure would similarly face insolvency. For that reason, the Defendants say, they thought that it was in Extrasure's interests for Citygate to be kept alive.

113. In support of that argument, both Mr Scattergood and Mr Beauclair said that Extrasure was unlikely to be able to survive as a "stand alone" company. Mr Beauclair also mentioned that Citygate was the broker on a number of policies sold by Extrasure, and accordingly Citygate's liquidation would have a serious effect on it. For his part, Mr Law accepted that Extrasure was "dependent" on Inbro Holdings and that, if Inbro Holdings went into liquidation, then Extrasure would be "threatened".

114. I accept that, if Inbro Holdings went into liquidation, then Extrasure would indeed be threatened. It plainly owed a substantial amount of money on the "loan account", and it had an underwriters deficit in its IBA. Furthermore, it was enjoying economies of scale by sharing administrative expenses with Citygate, which accrued only by reason of being a subsidiary of Inbro Holdings, and would not be available if it was forced to trade on its own. However, there was clearly no inevitability about Extrasure going into liquidation just because its parent did. The liquidator of Inbro Holdings might indeed demand repayment of the inter-company debt due from Extrasure, which it would be unable to pay. Alternatively, the liquidator might forgo the debt and sell Extrasure to a purchaser who was prepared to take on the existing inter-company debt as part of the purchase arrangements (as had happened in 1996), in which case Extrasure would survive. But there clearly was a real threat to its future if Inbro Holdings went into liquidation.

115. However, all of the above consists of comment after the event. The question I must answer is whether the Defendants honestly thought, on the 17th August, that it was in Extrasure's interests that Citygate should survive, and whether they thought there was any realistic prospect of Citygate being able to repay the money, or whether they simply plundered Extrasure's bank account without regard to its interests, because they knew that Citygate needed the money urgently, and there was no other available source of funds. I have some difficulty in resolving this issue, and the Defendants have themselves to blame for my difficulty. Their principal case was that they thought the transfer was in Extrasure's interests because it repaid a company debt. For the reasons I have already given, I consider that to be a story they have concocted after the event, in order to justify their conduct. By presenting their case in that way, they have also obscured any clear view of what they *did* in fact think on the 17th August.

116. In seeking to resolve this issue, I will therefore have to consider whether there was any reasonable basis for holding such a belief. If not, that is a powerful indicator that no such belief was in fact held by the Defendants at the time.

117. The Defendants relied in evidence on a number of matters in this regard:

117.1.the expected receipt of £500,000 from new business in Greece to be generated by Mr Rider;

117.2. the fact that other new business was being obtained for Citygate;

117.3. their understanding of Citygate's financial position, from the solvency tests and the latest accounts and trial balances;

117.4. the fact that deferred consideration was due form Coyle Hamilton in relation to the sale of part of Citygate's business;

117.5. the PwC report.

118. I will deal with each matter in turn.

119. Very heavy reliance was placed in the Defendants' evidence on their alleged expectation of receiving £500,000 in brokerage from certain new Greek business promised by Mr Rider (the Chairman of Citygate). Indeed, Mr Beauclair went so far as to say that he would not have approved the transfer but for his expectation in this regard. Both of the Defendants stated that they were satisfied that this money would be received, and emphasised that Mr Rider was an experienced broker who had produced substantial income in the past. However, the more that this issue was explored in crossexamination, the less likely it appeared that the Defendants could have had any reasonable expectation, in August 1999, that such a significant sum of money would be received within the foreseeable future.

119.1. Citygate's various budgets for the year ending the 30th June 2000 forecast brokerage in the region of £1 million to £1.385 million. A further £500,000 would therefore have increased its income by nearly 50%: and yet there is not a single piece of paper, and apparently neither Defendant ever saw or asked to see any paper, to show that extra income in anything like that amount was genuinely expected. The most that Mr Scattergood could say in evidence was that he remembered meeting a Greek gentleman who was supposed to be the source of the business. In my view, that evidence falls well short of what one might expect to see if there was any realistic prospect of such business being achieved.

119.2. Mr Beauclair stated in evidence that Mr Rider had been talking about the Greek business since before Mr Scattergood returned to Citygate. The money had been "about to arrive" since about April 1999. Mr Beauclair could offer no grounds for explaining why he had such confidence that the money was about to arrive in August 1999, when it had supposedly been imminent for several months, and had still not appeared.

119.3. When the Defendants met Mr Boardman on the 16th August, they did not mention the expected Greek money. This is surprising, if in fact there was a realistic prospect of it arriving soon: the Defendants were seeking the best available professional advice on whether money should be put into Citygate, so it seems inconceivable that they would not have made the best case to their professional adviser as to Citygate's ability to repay.

119.4. Exactly the same point can be made about the meeting with RBS on the same day. Again, the Defendants admitted that they did not mention their expectations about the Greek money to the bank. If they were trying to persuade the bank to lend Citygate money, it would have made perfect sense to present the best possible picture of its prospects. The fact that they did not do so suggests strongly that they did not have any real confidence in the money arriving, or certainly not within any foreseeable time-frame. The position is even more striking because Mr Rider, who was meant to be producing the new business, was present at the meeting with RBS.

119.5. The Greek money was never reflected in any of the budgets presented by Citygate to Lloyd's. If there really had been such a high degree of certainty about the money arriving as the Defendants suggested in their evidence, then there would have been no reason to be coy about it with Lloyd's. As it was, no mention was made of it.

119.6. No reference is made to the directors' expectation of receiving £500,000 in their report to the creditors of Citygate in its liquidation. If the directors had kept trading in the expectation of receiving this money, it is surprising that they did not mention it.

119.7. Finally, Mr Rider's witness statement makes no mention of the possible Greek business (other than a passing reference to the fact that he might have been in Greece on the 17th August 1999, when the £200,000 was transferred). Since he was not called to give oral evidence, I can make no findings about his expectations in this regard.

120. For all these reasons, I do not consider that, in August 1999, the Defendants had any reasonable grounds for believing that £500,000 was about to arrive in Citygate. Furthermore, having seen them cross examined, I do not accept that they did believe that the money was about to arrive. They hoped that it might: but they did not believe that it would.

121. Turning to the next matter on which the Defendants relied, it is impossible to tell whether they were acting reasonably in relying on the expected growth of new business in Citygate. Mr Scattergood mentioned some new aviation business, and some new marine business, which were immediate cash generators. But no details were given of when this business was first obtained, or of the sums involved. Accordingly, I can place no real reliance on it. On the material they have chosen to put before me, I do not consider that the Defendants had any reasonable grounds for believing that this new business would be capable of generating sufficient profits in Citygate to enable it to repay £200,000 to Extrasure in the foreseeable future. As such, I do not consider that the Defendants held any such belief at the time.

122. The Defendants relied next on their understanding of the financial position of Citygate. In cross-examination, Mr Beauclair said that he was reasonably confident in August 1999 that Citygate was solvent, and that its books were not "materially out". He thought the company was owed between £1.5 million and £2 million. Both Defendants emphasised the fact that the unallocated cash did not detract from their understanding of the overall debtors position. They also relied on the fact that Mr Beauclair and his team were making progress in closing the unclosed months and collecting debts. I will therefore have to consider the financial information available to the Defendants in a little more detail.

123. Citygate made periodic solvency returns to Lloyd's. The Defendants relied in particular on the return signed by Mr Beauclair on the 29th July 1999. It showed a surplus above margin of £92,320. However, this could not possibly have been regarded by the Defendants as providing any independent verification of Citygate's financial position. The returns signed by Mr Beauclair were no better than the company's books on which they were based. They merely reflected Mr Beauclair's understanding of the financial records which he had inherited. If those records were flawed, then so were the returns.

124. Similarly, I do not consider that the Defendants could reasonably have relied on the budgets prepared by Mr Beauclair in defence of their decision on the 17th August 1999. Budgets are, by their nature, prospective and uncertain. Furthermore, the particular budget prepared by Mr Beauclair for the year ending on the 30th June 2000 forecast brokerage of £1,385,000. That was £385,000 more than the projected brokerage referred to in the PwC report. As it was, the PwC report commented that, even at £1 million, the projected brokerage anticipated a 38% increase in income, which "might be difficult to achieve". The difficulty in achieving £1,385,000 would be proportionally greater.

125. The Defendants were forced to recognise that there was an enormous amount of unallocated cash in Citygate. In cross-examination, they were repeatedly pressed on this issue. However, both of them insisted that the fact that there was so much unallocated cash did not detract from their understanding of the overall debtor position. In other words, they claimed to have been satisfied that they knew how much money was owed to the company, although they may not always have known in respect of which transactions the money was owed. In my view, this was a perilous view for them to take, if in fact it truly reflects their view at the time:

125.1. If the books of a company have been perfectly maintained, then it is true that unallocated cash does not mean that the overall debtor position is necessarily unclear. But, until cash has been allocated, the directors could not have known whether any, and if so which, debts had been outstanding for how long, and whether or not bad debt provision should prudently be made. This issue can be

graphically illustrated in this case. Mr Beauclair's evidence was that, in September 1999, it was finally appreciated that Citygate should have made provision in excess of £700,000 for bad debts, rather than for the figure of £273,000 identified in the PwC report.

125.2. Furthermore, until the cash has been allocated, it is impossible for the directors to determine whether the books have in fact been kept accurately. Once again, the obvious truth of this can be illustrated from the facts of this case. By September 1999, when work on the books of Citygate had progressed sufficiently, it emerged that "false accounting on a massive scale" (to use Mr Scattergood's words) had been practised in the period prior to Mr Beauclair's arrival.

126. In any event, the Defendants' insistence that unallocated cash did not detract from their overall understanding of Citygate's true financial position is directly contradicted by three more or less contemporaneous documents:

126.1. I have already observed that the letter to Lloyd's dated the 18th August 1999 effectively admitted that the directors did not know what the "true" bad debt position of Citygate was.

126.2. In the letter to Lloyd's dated the 13th September 1999, Citygate again admitted that it was "virtually impossible" to establish its true financial position, because of the large amounts of unallocated cash. I consider that that letter correctly reflects the true position as it was, and as it was understood by the Defendants to be, in August and September 1999.

126.3. In a letter from Mr Scattergood dated the 13th February 2001, in answer to the letter before action, he said that it was "categorically denied that the state of [Citygate's] finances was clear or known to the directors or the majority shareholder" (i.e. himself) in August 1999. It is true that he then went on to say that reliance was placed on the PwC report and on professional advice, but I have already considered those matters.

127. For these reasons, I consider that the Defendants had no reasonable basis for considering that the level of unallocated cash was irrelevant to their understanding of Citygate's financial position. Furthermore, I consider that, because of the high level of unallocated cash, they did not in fact believe in August 1999 that they had a truly reliable understanding of Citygate's financial position.

128. The Defendants also stated in their evidence that they relied on the fact that Mr Beauclair was making progress, during July and August, in allocating Citygate's cash and chasing creditors. On this basis, they said that they considered Citygate's cash flow problems to be short-term. However, I must treat their protestations in this regard with some caution. As late as the 13th September 1999, a letter was written by Mr Rider to Lloyd's Brokers Department stating that the directors considered the company to be solvent. The very next day, it went into insolvent liquidation. Mr Beauclair sought to explain this remarkable *volte face* by suggesting that, between the time when the letter of the 13th September was written and the moment when the company went into liquidation, he suddenly discovered that there had been deliberate false accounting in the records of Citygate in the period before he joined the company. I find this explanation inherently implausible. It also appears to be entirely inconsistent with paragraphs 15 and 16 of his own witness statement, which clearly show that the discovery of malpractice was made before the 10th September. It is also inconsistent with paragraph 12 of Mr Scattergood's witness statement, and paragraph 7 of his supplemental witness statement, which also clearly indicate that "false accounting on a massive scale" had been discovered at least "a few days" before the 14th September.

129. The Defendants rely next on the anticipated receipt of deferred consideration from the sale of part of Citygate's business to Coyle Hamilton. However, they could have derived very little comfort from this source. It was common ground that no further money would be due until June 2000 - nearly a year later.

130. Turning to the PwC report, in my view, no reliance could reasonably have been placed on it for the purposes for which the Defendants claimed to have relied on it in August 1999.

130.1. The PwC report was signed in early June, and was based on work done largely in April 1999. Four months later, the Defendants, having been directors of Inbro Holdings and/or Citygate for several months, should not have been placing any heavy reliance on an outside report of such age.

130.2. The question facing the Defendants on the 17th August 1999 was in any event not whether Citygate was solvent, nor whether its IBA solvency margin was satisfactory - which is what the PwC report was concerned with. The question in August was whether, after an injection of £200,000, there was any realistic prospect of that money being repaid in the near future. There is nothing in the PwC report to provide any comfort in that regard.

130.3. In fact, the PwC report presented a far from rosy picture: it showed that margins were tight, and that there were many unknown elements in the equation, including the question whether Inbro Holdings would ever be able to repay the inter-company debt owed to Citygate.

131. For these reasons, I consider that the various matters on which the Defendants have relied are unconvincing. I find that they did not have any reasonable grounds for believing that Citygate had any realistic prospect of repaying the £200,000 within any foreseeable time period.

132. Furthermore, the Claimants rely on the following additional matters in support of their allegation that the Defendants could not reasonably have thought, and did not think, that the transfer was in Extrasure's interests:

132.1. It was made against the advice of the accountant, Mr Boardman. Moreover, that advice was given on the express basis that the Defendants were "unsure of the state of affairs" of Citygate's finances. The Defendants' only explanation for their decision to reject Mr Boardman's advice was that they considered that they knew more about the company's finances than he did. In my view, this was an odd response. There is little point in directors obtaining professional advice unless it is properly informed advice: they should not have been withholding information from Mr Boardman if it was capable of affecting his conclusions. I do not believe that the Defendants were in fact any more sure about the state of Citygate's finances than Mr Boardman's letter suggests.

132.2. The decision to transfer money to Inbro Holdings was taken in the face of RBS's reluctance to advance a loan to Citygate: in other words, the Defendants were prepared to chance Extrasure's money where the bank was not prepared to chance its own money. However, banks are naturally cautious with their money, and RBS said that they were particularly cautious even for a bank. In the circumstances, I derive little assistance from the fact that RBS refused Citygate a loan.

132.3. The money paid over to Citygate was needed by Extrasure to pay underwriters. By transferring the money to Citygate, the Defendants were putting Extrasure in exactly the same position as Citygate had been in immediately before the transfer.

132.4. The effect of the transfer was to strip almost all of Extrasure's cash from its bank account. Only about £58,000 was left.

132.5. On the Defendants' evidence, Citygate only needed £114,000 to pay United Capitol. The effect of the transfer was to give Citygate a float of £86,000 which it did not immediately need in order to meet Mr Sloan's ultimatum. Again, this cannot be denied.

132.6. The effect of the transfer was simply to prefer Citygate's creditors to those of Extrasure. Mr Beauclair admitted that he recognised this was what they were doing.

133. For these reasons, I find the grounds upon which the Claimants sought to rely persuasive. They reinforce my view that the Defendants had no reasonable grounds for believing that Citygate had any realistic prospect of repaying the £200,000 within any foreseeable period of time.

134. Finally, there are some additional factors to be taken into account:

134.1. The whole question of transferring money to Citygate self-evidently only arose because there was clearly a cash crisis in the company. Furthermore, the problem with United Capitol was not an isolated incident. Cash flow was a chronic problem which had plagued Citygate for as long as the Defendants had been working on its business since May. The demands made by Coyle Hamilton illustrate the same problem. The only question they had to address was whether it was a short-term or a long-term problem.

134.2. The Defendants knew that Citygate's brokerage was well below budget in May, and the information available on the 17th August suggested that it was also below budget in July.

134.3. With the departure of Mr Fairbrother, and the delayed return on Mr Picket, there was a serious shortage of experienced accounts staff.

134.4. It is common ground that the books were in a mess, and Mr Beauclair admitted to the liquidator that no "reasonable" trial balance was available until September 1999. On that basis, Mr Beauclair was, by his own admission, working from a trial balance which he did not consider to be reasonable in August.

134.5.One of the most telling pieces of evidence was another comment made by Mr Beauclair in his statement to the liquidator. He said that the transfer was made in order to give time to establish "whether or not" his fears about a hole in Citygate's IBA were unfounded. In other words, it was clear to the Defendants at the time that they had no idea whether Citygate would be able to repay.

134.6. For the reasons set out in relation to Issue (1), I do not believe that the Defendants even considered the question whether Extrasure owed Inbro Holdings any, and if so how much, money on the 17th August 1999. That being so, it is difficult to see how they can claim to have properly considered its interests.

134.7.No arrangements were put in place for repaying the money. The Defendants did not even trouble to make a written record of the terms upon which it was transferred from Extrasure to Inbro Holdings, or from Inbro Holdings to Citygate. In short, no mechanical steps were taken to protect Extrasure's interests.

134.8. Overall, the Defendants' conduct on the 17th August was at best high-handed. They took a critical decision on behalf of Extrasure without attempting to contact the Managing Director. They took a critical decision on behalf of Inbro Holdings without attempting to contact the other 2 directors. And they took a decision on behalf of Citygate when Mr Scattergood was not even a director of that company.

134.9. Finally, although hindsight is dangerous, it may be helpful to see what Mr Boardman said shortly after the event. On the 6th December 1999, he spoke to the liquidator of Citygate. His own file note of the conversation reveals that he said that the transfer was almost certainly unwise with hindsight "and probably could be seen as such at the time". In re-examination, he explained this comment on the basis of his earlier advice to put a *cordon sanitaire* around Citygate, and of his doubt about the wisdom of using the then available financial records as a basis for the decision.

135. For all these reasons, I do not believe that in August 1999 the Defendants had any reasonable basis for considering that Citygate would be able to repay the £200,000 within the foreseeable future. Indeed, they had no reasonable basis for forming any certain view about Citygate' s finances at all.

136. Having considered all the evidence, I also find that the Defendants knew in August 1999 that they had a thoroughly imperfect understanding of Citygate's ability to repay the money.

137. That being so, I must reject the Defendants' suggestion that they believed the transfer was in Extrasure's interests on the basis that it was calculated to preserve the group, and thereby to protect Extrasure itself. I do not believe that they actually formed any opinion on that issue at all. Rather, I am driven to the conclusion that they transferred the money on the 17th August 1999 simply because Citygate desperately needed it.

Issue (3): Did the Defendants have any reasonable grounds for thinking that the transfer was in Extrasure's interests?

138. If the Defendants failed to give any actual consideration to the question whether the transfer was in Extrasure's interests, then the next question (according to the *obiter* remarks of Pennycuick J in Charterbridge) is whether a reasonable director in their position could have thought that the transfer was in its interests.

139. For the reasons I have already given in answering Issue (2), I consider that the answer to this question is plainly "no".

Issue (4): Was the transfer made for an improper purpose?

140. Applying the four-part test which I have set out above, I can answer this question equally briefly:

140.1. the power in question was the directors' ability to deal with the assets of Extrasure in the course of trading;

140.2. the purpose for which that power was conferred on the directors was broadly to protect Extrasure's survival and to promote its commercial interests in accordance with the objects set out in its Memorandum;

140.3. the Defendants' substantial purpose in making the transfer was, as I have found, to enable Citygate to meet its liabilities, not to preserve the survival of Extrasure;

140.4.as such, the purpose for which the transfer was made was plainly an improper one.

141. The parties made written submissions after trial by reference to the objects clause in Extrasure's Memorandum of Association (which was not available at trial). The Defendants drew attention to clause 3(F) of the Memorandum, which enabled Extrasure to provide guarantees of the obligations of its parent or fellow-subsidiary companies, whether or not it received any consideration or advantage therefor. However, providing a guarantee is not the same as simply paying money to a fellow subsidiary. Furthermore, clause 3(Q) appears more nearly to fit the circumstances of this case: and under that provision a loan could only be made if it was calculated to benefit the company.

142. In any event, as the Claimants correctly observed, the fact that a transaction might fall within the terms of a company's Memorandum of Association only means that it is *intra vires* the company. It does not mean that it necessarily represents a proper exercise of the directors' powers.

143. Finally, given that the third stage in the four-part test set out above is a question of fact, and given also my factual findings in relation to Issues (1) and (2) above, I do not consider that the Defendants can credibly suggest that they considered the transfer was made for the proper purposes of Extrasure's business.

Issue (5): Was the transfer *ultra vires* the directors?

144. By amendment at trial, the Claimants advanced a new allegation that the decision to transfer the £200,000 was *ultra vires*. Although pleaded as an allegation that the decision was *ultra vires* the company (i.e. outside its corporate capacity), this was in fact intended (and, from the terms of the Amended Defence, it was clearly understood by the Defendants) as an allegation that the decision was *ultra vires* the directors (i.e. outside the powers delegated to them by the company's Articles of Association).

145. Article 25 of Extrasure's Articles of Association provide that the quorum for a meeting of directors shall be 3. However, this provision appears at first sight to be at odds with Article 18, which provides that the minimum number of directors shall be 2. Mr Chapman for the Defendants initially sought to explain Article 25 as requiring a quorum of 3 directors only in relation to the transaction of business covered by Article 24, namely contracts in which a director has an interest. But in my view that interpretation cannot be right. Article 25 is plainly in general terms, and it applies to any meeting of the directors. I suspect that the true position is that Article 18 allows the company to continue with only 2 directors, but that if they wish to conduct any business on behalf of the company they would have to appoint a third director in order to render any board meeting quorate. For the purpose of filling a casual vacancy, but no further, 2 directors might lawfully act on behalf of the company.

146. Mr Chapman's next argument was that the bank mandate (which was passed at a board meeting at which 3 directors were present) allowed any 2 signatories (including the Defendants) to issue instructions to RBS. As such, he says that the Defendants had the authority of the board to issue instructions to the bank. However, I cannot accept that argument either. The bank mandate only has contractual effect as between the company and the bank: if the bank receives instructions in accordance with the mandate, it is entitled and required to act on them. But that does not affect the means by which a lawful decision could be taken by the company itself to issue such instructions. The Articles show that a board meeting would not be quorate without 3 members present, and there was no meeting on the 17th August at which 3 members were present. For these reasons, I find that the Defendants had no authority delegated to them as directors of Extrasure to take the decision to transfer £200,000 to Inbro Holdings.

147. In the Amended Defence, and in the course of cross-examining Mr Law, Mr Chapman drew attention to the fact that, at 4 board meetings held between the 9th August 1996 and the 14th January 2000, business was purportedly transacted although only 2 directors were present. However, in argument he cited no authority for the proposition that this could have any effect on the quorum requirements in the Articles. Although it was not cited in argument, the decision in Ho Tung v. Man On Insurance Co [1902] AC 232 shows that company Articles may be adopted informally by long usage. But I would be loath to extend that principle to an informal amendment of Articles that have been adopted formally in the absence of very clear evidence of long usage, and further citation of authority. In the circumstances, I consider that the fact that certain other board meetings of Extrasure may also have been inquorate does not assist the Defendants in relation to the meeting on the 17th August.

148. Mr Chapman's final line of defence depended on ratification. However, he deployed this argument more generally in answer to the claim, and I will deal with it separately.

Issue (6): Was Mr Scattergood in a position of conflict of interest?

149. The Claimants allege that, since he was a majority shareholder in Inbro Holdings, Mr Scattergood was in a position of conflict in participating in a decision by Extrasure to transfer money to Inbro Holdings. In my view, Mr Chapman was right to suggest that this adds nothing to the Claimants' case. I also consider that he was right to point out that, since Extrasure was a subsidiary of Inbro Holdings, Mr Scattergood's own interests as a shareholder in Inbro Holdings were not in conflict with his duties to Extrasure. I would reject this allegation by the Claimants.

Issue (7): Was the transfer ratified?

150. The Defendants sought to argue that the transfer by Extrasure (and hence any breach of duty by the Defendants, or any want of authority on their part) was ratified by the approval of Inbro Holdings.

151. In support of this argument, Mr Chapman said that Inbro Holdings was "present" at the meeting on the 17th August 1999 by its directors, the Defendants, and that it clearly approved the transfer by Extrasure because it participated in the subsequent instruction to the bank to transfer the proceeds to Citygate.

152. I am unable to accept this argument. There was no evidence to suggest that a board meeting of Inbro Holdings had been convened on the 17th August. Furthermore, it is recognised that Mr Scattergood was at best *a defacto* director. As such, only one of the three *de jure* directors of Inbro Holdings was present at the meeting. In the circumstances, I cannot accept that the Defendants' decision to transfer the funds can be treated as a decision by them in their capacity as directors of Extrasure, and at the same time as a formal act of ratification by them as directors of Inbro Holdings.

153. Mr Chapman's answer was to seek to rely on a further layer of informal, implied ratification. He argued that, since Mr Scattergood was the majority shareholder in Inbro Holdings, his own informal approval *qua* shareholder in Inbro Holdings of his own decision (with Mr Beauclair) *qua* director of Inbro Holdings was sufficient to constitute ratification of his own decision (with Mr Beauclair) *qua* director of Extrasure. He relied in this regard on Re Torvale Group Limited [1999] BCLC 605 at 613e-618c. However, I do not believe that that case supports Mr Chapman's argument. It is trite law that all the members of a company, acting together, can do informally that which the Articles require to be done formally by ordinary or special resolution: that much is clear from Re Duomatic Limited [1969] 2 Ch 365 and Cane v. Jones [1980] 1 WLR 1451. The only layer of gloss applied by Torvale was that the same principle could apply equally where a decision is required to be taken by a particular class of shareholders, as well as applying to decisions of the general body of shareholders. The Judge was not saying that a bare majority of

shareholders can achieve informally that which the company's Articles require to be achieved by means of a formal resolution. Furthermore, it is clear that there must be actual ratification: Re D'Jan of London Limited [1994] 1 BCLC 561 at 563g-564b. Here, there was no act of overt ratification by Inbro Holdings, and Mr Scattergood did not represent all the shareholders in that company. In the circumstances, I do not consider that his position as the majority shareholder in Inbro Holdings can have had the effect of providing informal, implied ratification on behalf of that company to the acts of the Defendants as directors of Extrasure.

154. For these reasons, I do not consider that the transfer (or any breach of duty or want of authority on the part of the Defendants) was ratified by Inbro Holdings.

Issue (8): Ought the Defendants to be excused?

155. The Defendants rely on s.727 of the Companies Act 1985. They say that they acted honestly and reasonably, and ought fairly to be excused. In relation to the transfer of £200,000, I have not found that they acted dishonestly, in the sense that I have not found that they had any corrupt motive of personal gain, nor did they positively desire to do harm to Extrasure's interests. Rather, I have found that there was an absence of any honest belief that the transfer was in Extrasure's interests. Furthermore, given the circumstances of the transfer to Moneyguard, and in particular the knowledge of those involved in the new parent company, with which I deal below in relation to the second claim, I might well have taken the view that, in all the circumstances, the Defendants ought fairly to be excused. However, it follows from my findings in relation to Issues (1) and (2) above, that I do not consider that they acted reasonably. In the circumstances, I cannot excuse them pursuant to s.727.

Issue (9): Has Extrasure suffered any loss?

156. In the Defence it was suggested that Extrasure had not suffered any loss as a result of the transfer. In particular, the Defendants put the Claimants to proof of any attempts that Extrasure had made to recover the £200,000 from Inbro Holdings. However, no evidence was adduced to show that Extrasure had proved in the liquidation of Inbro Holdings, or whether any dividend can be expected for unsecured creditors.

157. Furthermore, even if there is no prospect of any recovery from Inbro Holdings, there remains the question whether the full £200,000 represents the amount of Extrasure's loss. There was undoubtedly a debt owed to Inbro Holdings, and the transfer had the effect, as a matter of book-keeping, of extinguishing that debt. In the circumstances, it seems to me wrong in principle to award Extrasure judgment in the sum of £200,000 outright.

158. Subject to the question of mitigation, with which I am about to deal, my provisional view is that the correct approach would be to give judgment for equitable compensation to be assessed, on the basis that the compensation should be quantified by reference to the amount by which the assets of Extrasure have in fact been diminished - i.e. giving the Defendants credit for (i) any dividend available in winding-up of Inbro Holdings and (ii) the amount by which the inter-company debt was in fact repaid. However, I have not heard full argument on this issue, and I will defer any final judgment on it until the parties have had time to consider their positions.

Issue (10): Has Extrasure failed to mitigate its loss?

159. The Defendants sought to argue that Extrasure had failed to mitigate its loss. As a matter of principle, I am not satisfied that a *cestui que trust* is necessarily under the same duty to mitigate as a claimant for damages at common law. The Defendants relied in this regard on Target Holdings Limited v. Redferns [1996] AC 421 at 438D-439B. However, that case was dealing with the question of causation, rather than mitigation.

160. Assuming that I am wrong, the next question is whether there was in fact a failure to mitigate. The Defendants' argument in this regard is ingenious. They say that, as a result of the transfer, Trans Continental paid less for the shares in Extrasure than it otherwise would have done. On that basis, the Defendants say that Trans Continental falls under an implied duty to account to Extrasure for the reduction in the purchase price, thereby reimbursing Extrasure for its loss.

161. Mr Chapman was unable to cite any authority in support of this argument, and I find myself unpersuaded by it. The Defendants owed their fiduciary duties to Extrasure. They were in breach of those duties. Extrasure is entitled to claim against them. The fact that Trans Continental may subsequently have acquired the entire issued share capital of Extrasure is irrelevant to that claim.

162. Furthermore, even if it could be argued that Trans Continental might be under some kind of implied duty to account to Extrasure for any reduction in the purchase price, the absence of any authority shows that it would be a novel and speculative claim for Extrasure to pursue against its own parent. It is clear that the duty to mitigate does not impose an obligation to pursue uncertain and speculative litigation.

163. For these reasons, I do not consider that Extrasure is under a duty to mitigate. But, even if it were, I do not consider that it has been guilty of a failure to mitigate.

(4) THE SECOND CLAIM

164. By a letter dated the 13th January 2000, Mr Scattergood was offered employment as Chairman and Chief Executive Officer of Moneyguard (now Trans Continental). The offer letter was signed by Mr Vincent and Mr Rider. Mr Vincent's evidence, in paragraph 52 of his witness statement, was that he only agreed for Mr Scattergood to be employed by Trans Continental on the basis of the assurance he claims Mr Scattergood had given in late 1999 that he (Mr Scattergood) had not been involved in any intercompany transfers between Extrasure and Inbro Holdings.

165. I have already set out the bones of the chronology. I must now return to the question whether or not Mr Scattergood lied to Mr Vincent in late 1999 about the Defendants' responsibility for the transfer of £200,000. For a number of reasons, I find it impossible to accept Mr Vincent's version of events in this regard:

    165.1. In the first place, Mr Tidman and Ms Bayley had been dismissed in July 1999. It is and was a matter of record that the transfer of £200,000 was not effected until the 17th August: that much would be clear from the bank statements and the cash book of Extrasure, even without having seen the fax signed by the Defendants on that day. In the circumstances, it is difficult to believe that Mr Scattergood would have said, or that Mr Vincent would have believed, that Mr Tidman and Ms Bayley were responsible for the transfer of £200,000.

    165.2. In late 1999, Mr Scattergood and Mr Beauclair were both hoping to establish a long-term joint venture with Mr Vincent. Mr Vincent's own evidence was that they met or spoke virtually every day, and certainly every week, in October and November 1999. In the circumstances, it seems unlikely that the Defendants would have wanted to lie to him about a transfer which they knew had been effected on their written authority. If it was told, it was a lie that was bound to be discovered, and was bound to spoil the joint venture relationship.

165.3. The purchase agreement between Moneyguard and Inbro Holdings for the acquisition of Extrasure referred at paragraph 10.1.1 of Schedule 6 to the repayment of a loan of £150,000. Mr Vincent clearly saw a copy of this agreement in draft, because there is a manuscript annotation to that effect dated the 7th January 2000. It would at least have put him on inquiry about the transfer.

165.4. It is clear from paragraphs 33, 34 and 39 of Mr Gyde's witness statement that, in early 2000, he obtained from Mr Law a copy of the fax dated the 17th August 1999, signed by Mr Scattergood and Mr Beauclair. Accordingly, if in late 1999 Mr Scattergood had indeed lied about his involvement in authorising the transfer of £200,000, then the lie had already been discovered in early 2000. Nevertheless, Mr Vincent does not appear to have taken any action based on that discovery until December 2000 at the earliest: the obvious inference is that he already knew about Mr Scattergood's involvement in the transfer.

165.5. Mr Law's evidence was to the same effect. He said that he raised with Mr Vincent in early 2000 the fact that £200,000 had been transferred out of Extrasure in August 1999 on the authority of the Defendants. Mr Vincent seemed neither interested nor surprised. Once again, the inference is that he already knew. If Mr Scattergood had deliberately lied to him in late 1999, and he had discovered the truth in early 2000, Mr Vincent's reaction would have been entirely different. It is true that Mr Vincent disagreed with Mr Law's recollection, claiming that Mr Law had only raised the issue of the transfer after Mr Scattergood had left the company: but, given the importance Mr Law attached to the matter, I prefer his evidence on the question of timing.

165.6. Mr Vincent's evidence was shown to be wrong in cross-examination on two small but related points. First, he insisted that in late 1999 he had seen the inter-company debt between Inbro Holdings and Extrasure on the latter's audited accounts: but, having been taken to the only signed accounts that existed at the time, he recanted. Secondly, he insisted that he had taken no interest in the negotiations for the purchase of Extrasure by Moneyguard in early 2000: but a manuscript note showed that he had in fact received a draft of the agreement while it was being negotiated on the 7th January 2000.

166. For all these reasons, I find it impossible to believe that Mr Scattergood told Mr Vincent in late 1999 that he had not been involved in any transfer of funds from Extrasure to Inbro Holdings. Although I have found Mr Scattergood to be an unreliable witness in certain other respects, I cannot automatically assume that everything he said in evidence was untrue. On this issue, for the reasons I have given, I prefer his evidence to that of Mr Vincent.

167. For these same reasons, the whole evidential basis on which the second claim is based must fail.

168. Even if that were not so, I would have taken a great deal of persuasion that Trans Continental was entitled to any damages. It is common ground that the contract of employment has been terminated. It is no part of the Claimants' case that Mr Scattergood provided inadequate services while the contract was in force. Accordingly, I did not understand what loss Trans Continental could claim to have suffered.

(5) CONCLUSIONS

169. For the reasons I have explained at some length, I am minded to give judgment in respect of the first claim in favour of the First Claimant against both Defendants for equitable compensation to be assessed for breach of their fiduciary duties. I will hear further argument as to the basis on which such compensation falls to be assessed if necessary. I will dismiss the second claim by the Second Claimant against the First Defendant outright.

Jonathan Crow
22nd July 2002