

Robbing Peter to Pay Paul: BVI Appeal Court Guidance on Insolvent Company Payments

In the recent British Virgin Islands ("BVI") appeal of *Byers v Chen*¹, the Court of Appeal (the "Court of Appeal") reaffirmed the principle that when a company is insolvent, or bordering on insolvency, a director owes fiduciary duties to the company and the company's creditors. A director authorising a transaction that breaches this duty is likely not to escape personal liability, even if there is no personal gain to the director and such transaction is balance sheet neutral.

Background Facts

Pioneer Freight Futures Company Limited ("PFF") is a BVI company that traded in forward freight agreements ("FFA"). It was one of the largest forward freight traders in Asia with Miss Chen as its sole director and ultimate beneficial owner. Following the collapse of the FFA market in 2008, PFF's trade declined. Consequently, PFF entered into a loan agreement with Zenato Investments Ltd ("Zenato") where Zenato paid PFF US\$13 million. However, when PFF repaid Zenato (the "Payments"), PFF was insolvent.

Proceedings

PFF's joint liquidators ("JLs") issued proceedings in the BVI Commercial Court against Miss Chen,

claiming breach of fiduciary duties under the common law, due to Miss Chen preferring one creditor over the general body of creditors, when PFF was insolvent. Miss Chen defended primarily on the basis she was not a director at the time the Payments were made and that the Payments were balance sheet neutral, as PFF's liability to Zenato (a creditor of PFF) was discharged.

The case proceeded through to the Privy Council and the Board held Miss Chen was a director of PFF, and given PFF's insolvency, her inaction in failing to stop the Payments breached her fiduciary duties to PFF's creditors. In coming to its decision, the Board recognised and relied upon the longstanding creditor duty, as established as the rule in *West Mercia*, which was approved in *Sequana*.

The Board remitted the case to the BVI Commercial Court to decide the appropriate remedy. The JLs sought payment from Miss Chen in the sum of US\$13 million plus interest, however the trial judge held that since the Payments were balance sheet neutral, PFF suffered no loss and therefore no payment was due. The JLs appealed.

¹Mark Byers and Matthew Richardson (as Joint Liquidators of Pioneer Freight Futures Company Limited) and Pioneer Freight Futures Company Limited (In Liquidation) v Chen Ningning BVIHCMA 2024/0009.

Decision

The Eastern Caribbean Court of Appeal allowed the appeal and reaffirmed the rule in *West Mercia* that directors have a common law duty to consider and give appropriate weight to the interests of the company's creditors when they know or ought to know that the company is insolvent or bordering on insolvency.

Importantly, the Court of Appeal determined that whether a director has benefited from a transaction is not a relevant consideration in determining if the rule in *West Mercia* applies. Where the rule applies, the principle of separate legal personality serves a new function in protecting the interests of the creditors. Any loss to the general body of creditors is equated with that of the company.

Therefore, the Court of Appeal held that the trial judge was wrong to find that no payment was due from Miss Chen, even though the Payments were balance sheet neutral. In making the Payments, the company suffered a pecuniary loss equivalent to the financial loss suffered by the general body of creditors. If this were not the case, directors would be encouraged to breach their creditor duty on the false premise that a transaction which is balance sheet neutral causes a company no financial loss.

Consequently, Miss Chen was ordered to pay the sum of US\$13 million plus interest to the JJs. Further, the Court directed that in the distribution of the company's assets to the general body of creditors, the debt due to PFF is notionally increased by US\$13 million to what it would have been if the Payments had not been made.

The decision is an important clarification of the principles first established in *West Mercia* and reiterates the Eastern Caribbean Supreme Court's longstanding position of protecting the body of creditors when a company becomes insolvent. It is also a timely reminder to all directors to take legal advice when a company is insolvent or likely to become insolvent and, in particular, prior to making

any payment to a third party, even if that individual is a creditor of the company.

Further Assistance

The Maples Group's Dispute Resolution & Insolvency team has vast experience in advising liquidators and directors at every stage of the insolvency process and do reach out to us should you need assistance in this regard.

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