

2. On 4th September 2017, after a lengthy trial, Her Honour Hazel Marshall QC, Lieutenant Bailiff, dismissed all the claims brought by the Appellants (being the liquidators of Carlyle Capital Corporation Limited (“CCC”) together with CCC itself) against the former directors (the First to Seventh Respondents) and the former investment manager (the Eighth Respondent) of CCC. She also dismissed claims against two corporate entities associated with the Carlyle Group but no appeal is brought in respect of the latter decision.
3. The Appellants now appeal against certain aspects of the Lieutenant Bailiff’s decision and seek a finding that the Respondents were in breach of their respective duties owed to CCC and a consequent award of damages in the region of US\$320-360 million.
4. Unsurprisingly, in view of the length of the trial and the amount of documentary and witness evidence presented to the Lieutenant Bailiff, the judgment runs to some 524 pages containing 2,643 paragraphs. Fortunately, in view of the limited nature of the grounds of appeal, it is not necessary to record all of the Lieutenant Bailiff’s findings. We propose to proceed by summarising the factual background and the nature of the claims before the Lieutenant Bailiff before going on to give a brief description of the Lieutenant Bailiff’s decision. We shall then consider in more detail her findings in respect of the matters under appeal when we turn to discuss the individual issues which arise for our determination.

Factual Background

5. We take this from the judgment. However, that is more detailed than is required for our purposes. The Respondents have produced a summary of the judgment as part of their written case for this appeal and, where we are satisfied that that summary accurately reflects the facts as found in the judgment, we have drawn upon that summary.
6. The Carlyle Group was at all material times a large and well-known global asset management company. It was founded in 1987 by the First Respondent (“Mr Conway”) and two others. In 2005, Carlyle began to consider creating an investment entity referred to as a “yield vehicle” to provide investors with a relatively high but steady dividend return. It would be publicly listed so as to enable investors to realise their investment easily.
7. In consultation with the banks who were to underwrite the offering for the new entity, Carlyle developed a business model which was intended to be distinctive from anything currently in the market. It was to achieve its objectives by investing in a combination of high quality fixed income assets and riskier (but therefore higher earning) leveraged finance and credit assets (“LFA”). The chosen high quality fixed income assets were residential mortgage backed securities (“RMBS”). The LFA had historically shown patterns of volatility which were uncorrelated with those of RMBS, and it was felt this combination would buffer and even out the effects of price volatility risk.
8. The Lieutenant Bailiff described the RMBS in which CCC invested at [81] – [92] of her judgment. RMBS are created when an entity pools together mortgage debts. The pools enjoy the rights to the future income streams and to the principal and interest paid on the mortgages. The pools are then securitised (that is, merged into tradeable financial instruments) and sold to investors. There is a great deal of variation in the structure and risk profile of these securities. CCC elected to invest in a specific type of RMBS referred to as ‘Agency AAA capped floaters’. The ‘Agency’ tag denotes that these securities were issued by one of three giant American agencies which were quasi-governmental issuers of securitised mortgage products. The two in which CCC invested were known, colloquially, as ‘Freddie Mac’ and ‘Fannie Mae’. The covenant strength of the two agencies was considered as the equivalent of that of the US government itself. Such RMBS were regarded, therefore, as having no credit risk. They were

seen as being a safe, secure and steady investment and tended to trade, in capital terms, at or very close to their par value. Agency RMBS would produce payment in full of their par value on maturity at the latest and each month the owner received payments reflecting amortisations, interest and any pre-payments received when the underlying mortgages were refinanced.

9. The RMBS were 'floaters' because they paid a floating interest rate which was slightly above that of one month London Interbank Offered Rate ("LIBOR"). They were 'capped floaters' because the interest rate payable was subject to a specified maximum called a 'cap'. The RMBS purchased by CCC were variously capped at 6.5%, 6.75% and 7%. The higher the cap, the more attractive and valuable the security is, potentially, because its return is less vulnerable to interest rate risk, i.e. the risk that LIBOR rates might rise to a point where the cap takes effect. References hereafter in this judgment to RMBS are to the type of RMBS held by CCC as just described.
10. CCC's RMBS were to be highly leveraged in order to increase the income return. Provided the costs of any borrowing were lower than the return on the assets purchased with the borrowed money, CCC would make a profit equal to the net difference. The more borrowed money was used, the greater the total amount earned, which, after paying the costs of funding, would remain in the hands of CCC as effective profit upon its own small amount of capital invested. However, just as such increased borrowing, or 'leverage' magnifies the profit being earned, it will also magnify any losses relative to invested capital.
11. The form of borrowing used to provide the leverage which CCC would be operating was 'repurchase financing' or 'repo'. The Lieutenant Bailiff found that repo financing was a standard and accepted method of financing borrowings for the purchase of securities at the time. It was an enormous market; the American repo market was estimated to have been some \$10 trillion in mid-2007 which was more than twice the value of US Treasury securities then outstanding. The Lieutenant Bailiff described in some detail the nature of repo financing at [97] – [114] of the judgment and we agree that that is conveniently summarised as follows (drawing on the summary contained in the Respondents' written case).
 - (i) The transaction is effected as a sale and repurchase, although it is in substance a loan and is treated as such in the books of the borrowing company. The assets are sold by the borrower (i.e. CCC) to the lender (i.e. the banks) at a price corresponding to their current market value, less a percentage known as the 'haircut', which in effect defines the agreed loan to value ratio. At the same time, the borrower undertakes to re-purchase the securities after a time period at a price representing the amount loaned plus interest. The period generally operating in the present case was 30 days.
 - (ii) By using repo finance, the lending banks maintain title to the securities during the period of the loan and would be in a position quickly to liquidate the securities in order to cover their exposure in the event of a default by the borrower. It would also enable the lender to side-step any problems caused by the bankruptcy of the borrower in relation to the assets the subject of the repo finance. The haircut provides the lending bank with protection in the event of default by the borrower, against (i) its selling costs; and (ii) the possibility that the market price of the assets has fallen since the start of the repo period.
 - (iii) The banks did not confine themselves to the haircut for protection. During the period of the repo transaction, the lender had the right to demand additional margin if the market value of the security declined, so as to bring the value of the security held by the lender back to the agreed loan to value ratio – i.e. in effect to maintain the agreed level of haircut between the value of the securities and the

amount of the loan. Conversely, if the price increased, the borrower had the right to make a margin call for cash back so that the lender did not maintain excess collateral.

- (iv) Until the events with which the current proceedings are concerned, repo finance banks as a matter of course assessed the market value of securities by reference to third party pricing sources. For present purposes the principal pricing agency, whose day-to-day published price assessments were used was that known commonly as 'IDP' or 'FT' (there having been a change of name). However the repo agreements contained a provision entitling the lending bank itself to decide what market value it would attribute to the assets in question, which it would then use to decide on margin calls. The only restriction on the repo bank was that it had to act 'reasonably' or 'in good faith' in its pricing; but, as transpired during the events in question, the provision gives great power to the lending bank.
 - (v) Repo transactions were not bound to be renewed. However, the Lieutenant Bailiff was satisfied that, until about mid-2007, once counterparties had agreed the terms for a repo transaction, the borrower could generally expect that renewals would be on the same material terms as previously, particularly as regards the agreed level of haircut.
 - (vi) Typically, repo interest rates charged by banks were set slightly below LIBOR and were very similar because the lenders were in competition for business. The RMBS in question paid a rate of interest just above LIBOR. Because both interest rates were set by reference to LIBOR, the difference between borrowing costs and interest income remained relatively constant, thus minimising interest rate funding risk.
 - (vii) Because the period of the RMBS could in theory be up to as much as 30 years before redemption and the repo financing was for a mere 30 days, repo transactions were repeat business. They would come up for renewal or 'roll' at 30 day intervals which were timed to coincide with the monthly payments made by Fannie Mae and Freddie Mac respectively.
 - (viii) The Lieutenant Bailiff found that in the case of agency capped floaters, it was reasonable to regard a 2% haircut as typical for a tier 1 borrower and that CCC was regarded as a tier 1 borrower because of its association with Carlyle.
12. CCC was incorporated in Guernsey on 29th August 2006. Its Board of directors consisted of five voting and two non-voting directors. The two non-voting directors were the Third and Fourth Respondents ("Mr Stomber" and "Mr Zupon"). They both worked for the Carlyle Group. Mr Stomber had been brought in specifically to take charge of a 15 person team which would be devoted to running the affairs of CCC. Mr Zupon was to be responsible for the LFA part of the portfolio.
13. The five voting directors were Mr Conway, the Second Respondent ("Mr Hance") and the Fifth to Seventh Respondents ("Mr Allardice", "Mr Sarles" and "Mr Loveridge"). The Lieutenant Bailiff described in some detail their experience and financial expertise. Mr Hance was the non-executive chairman of the Board. The Articles of Association included a requirement for Independent Directors and certain matters had to be approved by a majority of the Independent Directors. The Independent Directors were Mr Allardice, Mr Sarles and Mr Loveridge.
14. The day to day management of CCC was the responsibility of the Eighth Respondent ("CIM") acting pursuant to an Investment Management Agreement entered into in September 2006.

Certain CIM employees were dedicated exclusively to managing CCC's RMBS portfolio and were referred to as 'Management'. Mr Stomber led the team at CIM.

15. CCC also had an Asset and Liability Committee ("ALCO"), the membership of which was Mr Stomber and other senior members of Management. The Board members were invited to attend ALCO meetings and had access to ALCO papers. ALCO met twice monthly from June 2007 until CCC's collapse. Wherever possible, ALCO meetings were timed to take place before or after other formal meetings. The purpose of ALCO was to review market events and conditions that might impact on CCC, examine the performance of CCC's investments on a regular basis, review CCC's compliance with its Investment Guidelines, and discuss various risk and performance matrices and the management of CCC's liquidity cushion.
16. The Board established three Investment Guidelines that could only be changed by a decision of a majority of the Independent Directors. The Investment Guidelines were described in detail by the Lieutenant Bailiff at [187] – [215] of the judgment.
17. Guideline 1 related to asset allocation and ultimately provided a maximum figure of 85% for RMBS as against the LFA. As already mentioned, the RMBS were to be highly leveraged and, at the time of the Initial Public Offering ("IPO") in June 2007, this was intended to be 32 – 37 x. The LFA, being the riskier assets, were only to be leveraged at 1 – 8 x.
18. The second Investment Guideline (the "Liquidity Guideline") related to the liquidity cushion. In view of the nature of CCC's business model and the ability of repo lenders to call for margin (i.e. additional security) in the event of a fall in the market value of assets during the repo finance period, it was important to maintain a liquidity cushion (i.e. cash or other liquid assets) which would be available to meet immediate financial obligations such as the provision of additional margin. The figure selected was 20% of CCC's net asset value. This figure was reached on Mr Stomber's recommendation. CCC's business model was tested against the conditions of the worst liquidity crisis in general memory, which was the Long Term Capital Management ("LTCM") crisis of 1998. The principle of the stress test applied was that of modelling what liquid resources would have been required in order to survive the conditions of that crisis to a 99% confidence level, on the assumption that no corrective measures to the portfolio were taken for 20 business days. This is known as a 'stressed VaR' ("Value at Risk") assessment. The parameters were conservative, both as to the '20 days with no corrective action' assumption and as to the 99% confidence level. Typically, VaR analyses were carried out on a more normal basis of a one day inactivity period and a 95% degree of confidence. The stressed VaR analysis had thrown up a 16% liquidity cushion requirement. Mr Stomber had then added 25% of this for further safety, to reach the 20% figure. He told the Lieutenant Bailiff that the reason for adding 25% was in order to be conservative as against even the worst financial crisis which could be pointed to.
19. The third Investment Guideline related to minimum borrowing capacity. It was that CCC would maintain a minimum borrowing capacity of 150% of its anticipated actual repo borrowing requirements. In practical terms, this Guideline translated, in relation to CCC's RMBS portfolio, into CCC's maintaining promises of unused available repo finance from potential repo lenders roughly equal to 50% of the value of the RMBS portfolio. The point of this guideline was to ensure that CCC had an available backstop finance facility to give it flexibility in case it wished to 'roll away' from any particular repo counterparty, and to enable it to do so without coming under any stress as to borrowing terms.
20. CCC raised initial funds through a private placement of shares in two tranches in December 2006 and February 2007. A total of \$600m was raised, essentially from supporting investment banks and existing Carlyle Investors.

21. Subsequently an Initial Public Offering (“IPO”) took place and was completed on 11th July 2007. This brought the total capital raised to \$945m.
22. The first signs of instability in the US sub-prime markets had begun to emerge in June 2007. However, they did not directly affect CCC’s portfolio which held only prime mortgage assets. The Board met on 26th July 2007 after completion of the IPO and an ALCO meeting was held the same day. It was decided that, in view of concerns in relation to liquidity and the markets generally, there would be a freeze on the purchase of further LFA. A few days later, on 31st July 2007, following losses on the LFA portfolio, CCC management decided to go “*ultra-safe*” and make no further purchase of any securities, including RMBS.
23. On 7th August following a decline in the value of CCC’s RMBS portfolio, Cantor Fitzgerald, one of CCC’s repo lenders, made a margin call. Whilst the demand was negotiated back to a lesser sum, CCC rolled its repo away from Cantor Fitzgerald on the next occasion. In response to signs of turbulent market conditions, Mr Stomber asked the Independent Directors to reduce the minimum liquidity cushion from 20% to 15%. The Independent Directors agreed to this request on the basis that this was precisely the situation for which the liquidity cushion was established.
24. On 9th August, as the Lieutenant Bailiff put it, the ‘*financial markets were rocked*’ by the suspension of redemptions of three hedge funds managed by BNP Paribas because of a stated inability to value the sub-prime RMBS they held and an evaporation of liquidity. CCC received increasing margin calls over the following days. Some repo lenders began to abandon IDP prices and make margin calls based on their own price marks, as well as to start demanding higher haircuts. CCC paid its first haircut in excess of 2% at the repo roll on 15th August. The strategy at that stage was to focus energy on repo negotiations, to manage haircuts and maintain availability but to exude an image of strength and confidence and to take advantage of the Carlyle name.
25. On 16th August, immediately after the 15th August repo roll, Mr Stomber approached Mr Conway to ask whether Carlyle would be prepared to provide CCC with a \$100m loan as emergency funding. By then the liquidity cushion had fallen to 7%. The directors agreed to the taking of a loan from Carlyle and also acceded to Mr Stomber’s request to suspend the Liquidity Guideline so as to enable CCC to get through what he described as an ‘extreme period’. Thereafter meetings took place with the various repo lenders on 20th August. During the course of a meeting with JP Morgan (“JPM”), Mr Black of JPM recommended that CCC should immediately undertake the sale of \$10bn of its RMBS and he offered JPM’s services to assist in such a sale without charging. Following discussion in CCC’s Investment Committee (which comprised Mr Conway, Mr Hance, Mr Stomber and Mr Zupon) it was agreed that an immediate sale of \$10bn of RMBS was too draconian a step as it might cause the market, in particular CCC’s repo lenders, to question CCC’s ongoing viability and it could have adverse consequences in triggering lower marked prices for the value of the remaining RMBS, with a consequent liability for margin calls which would reduce or wipe out the liquidity gain; but it was agreed that the sale to JPM of up to \$4bn of RMBS should be pursued. However, the price at which JPM reverted was a very low price and it was decided not to proceed with the sale. The Lieutenant Bailiff noted that it was agreed by all the expert evidence in the case that the decision not to pursue the sale of \$4bn of RMBS at the prices offered by JPM was not only reasonable but indeed correct.
26. The loan from Carlyle had not achieved its intended purpose. It had been anticipated that the loan would be viewed by the market as a positive sign for CCC because it showed that CCC had Carlyle’s support. However, to the surprise of those involved, the immediate reaction was the opposite, with the Wall Street Journal portraying CCC as a ‘troubled’ fund that needed to be ‘rescued’. The result was a panic reaction amongst the repo lenders, who now almost all began demanding haircuts of 3%.

27. An emergency joint meeting of the Board and ALCO was held on 23rd August to discuss the deterioration in market conditions and its impact on CCC. After discussion, the Board adopted a number of measures intended to support and preserve CCC's capital and liquidity, with a view to ensuring its survival. These were:-
- (i) The sale of all CCC's LFA to generate liquidity.
 - (ii) A second short-term bridge loan of up to \$100m from Carlyle if necessary pending receipt of the proceeds of the sales of the LFA, if needed to meet margin calls in the interim.
 - (iii) Formal acceptance of the unsecured \$100m loan from Carlyle which had already been put in place as an emergency measure.
28. Further measures to improve liquidity were approved, namely that all asset purchases were suspended and there would be no payment of any dividend in the third quarter of 2007. Efforts would be concentrated on working on the company's lenders to increase repo lines at reasonable cost.
29. Lastly, the appropriate attitude to sales of RMBS was discussed. It was noted that these assets were *'money good'* meaning that ultimately, they bore no credit risk and would pay in full as to both interest and capital at maturity. The argument against selling them was that the prices currently available were just too low to be justified having regard to both the net financial benefits and the associated unquantifiable risks. The Lieutenant Bailiff continued at [1345]:-

“However, it was recorded that if CCC could accomplish sales at prices at or about CCC's marks (i.e. at a sufficiently small actual loss), then CCC should be open to doing so. In other words, it would take advantage of sales opportunities if these presented themselves.”

As we describe later, the Appellants say that the Lieutenant Bailiff fell into error when she used the words 'CCC's marks'.

30. To that end the Board was briefed by Mr Stomber in respect of the investigation of possible sales of RMBS to Fannie Mae and Freddie Mac. This was regarded as less risky than open market trading. However, Freddie Mac later offered prices which were described by Mr Stomber as a *'non-starter'*. The approach to Fannie Mae also proved to be a dead end.
31. The Lieutenant Bailiff accepted that at this meeting CCC had put in place what was subsequently called the "capital preservation strategy". The Lieutenant Bailiff agreed it was a convenient label for the broad general policy decision to retain RMBS and not sell them (unless a sufficiently advantageous opportunity presented itself) and to seek to ride out the crisis, relying on income, pre-payments and amortisations from the RMBS, and ultimately when markets had stabilised, to examine the appropriate future for CCC's business.
32. During September, market conditions had calmed somewhat from the turbulence of August but they were still difficult. At the beginning of September, CCC's liquidity cushion stood at 9.9% but increased to 16.8% on 10th September when sales of LFA came in although it fell to 8.8% immediately after the 15th September roll. Weighted average haircuts were 2.62% by the end of September.
33. Early in September, UBS enquired about buying some of CCC's RMBS and CCC responded with a list of securities it would be willing to sell. There was an issue as to whether the RMBS listed by the Appellants met the precise criteria provided by UBS but the Lieutenant Bailiff held

that CCC had handled the matter consistently with its policy of being minded to make sales if an opportunity presented itself and in the end nothing came of the proposed purchase.

34. On 11th September, the Carlyle Investor Conference took place in Washington and CCC was one of the matters on which a presentation was made. Various slides were presented. They made clear that the strategy was the capital preservation strategy and that therefore it was not intended to sell RMBS. One of the slides did refer to a figure of 40% liquidity and a question arose as to whether investors were being told that this was the plan. The Lieutenant Bailiff found that this was not so and this was simply an illustration of what CCC might look like, or aspire to look like, in the future as and when steps to shape a new business model in a more stable market environment could be taken. Repo rolls on 17th September and 25th September were managed although, as mentioned earlier, the required haircuts increased and various margin calls had been made during the course of the month.
35. On 1st October, at the request of Mr Stomber, the Independent Directors agreed to a further three months' suspension of the Investment Guidelines on the basis that it was impossible to comply with them in the present circumstances given the capital preservation strategy.
36. The month of October saw gradual but fluctuating improvement in the market for CCC's RMBS. Both repo rolls were achieved but with an average haircut of 2.65%. By the end of the month the liquidity cushion had risen to 19.2% and it touched 20.1% in early November before wavering somewhat and thereafter beginning to deteriorate.
37. Tightening up of liquidity over the fiscal year ends of banks is apparently a well-recognised occurrence in the financial markets and most of the banks providing repo finance had financial year ends of either 30th November or 31st December. By mid-November there was a tightening with banks hoarding liquidity and using distressed pricing to justify margin calls and repo availability coming under pressure. There was lowering demand which affected the prices for RMBS.
38. CCC's audit committee met on 13th November 2007 to review CCC's third quarter financial statement. As part of that review CCC's auditors, PwC, reported on work they had undertaken for a 'going concern' analysis, which assesses whether a company is reasonably expected to remain in business for at least the next 12 months. PwC confirmed they would issue their opinion in respect of CCC with no 'going concern' qualification.
39. Later the same day the full Board held its meeting. Mr Stomber presented updated business model projections that management had prepared as well as an analysis of the impact of the recent market crisis on CCC's financial position. He prepared a number of projections including 'likely case', 'downside case' and 'static portfolio'. The 'static portfolio' basically assumed no change with cash received from amortisations etc. simply being added to liquidity. The 'likely case' assumed that markets and price levels would return to what was perceived as normal by mid-2008 whereas the 'downside case' assumed a more pessimistic course. The assumptions for the 'downside case' were that haircuts all moved immediately to 3% and that RMBS prices fell to the lowest point of the 3rd quarter of 2007. These assumptions implied a cash shortfall of approximately \$13.7m in the fourth quarter of 2007 and it was suggested that to meet this there would be a sale of \$4bn of RMBS at the lowest price reached in the third quarter. The outcome of the Board meeting was that there was no change to the capital preservation strategy.
40. In late November, each member of CCC's Board (and several members of the management team) purchased additional shares of CCC's stock. They asserted that these purchases were made in the belief that CCC's share price was undervalued and so would generate attractive returns in consequence.

41. By the end of November, the repo rolls had duly taken place with an average haircut of 2.67%. The liquidity cushion stood at 10.5%.
42. The performance in December was largely flat. The repo rolls were achieved with an average haircut rate of 3.04% and liquidity stood at 9.3% at the end of the month.
43. After the year end had passed, CCC's financial position seemed generally to improve until mid-February 2008. Thus, at the start of January 2008, the liquidity cushion stood at 9.3% but rose to 16% by 10th January. It remained at or above this level (achieving 19.6% in early February) until 20th February. This occurred because repo lenders became obliged to return margin as a result of increases in the levels of repo marks. Thereafter, however, the tide began to turn and CCC received reports of adverse market conditions and increased volatility. There was a surge of selling in the RMBS sector without corresponding demand which drove down prices. CCC received margin calls of nearly \$40m on 14th and 15th February. The 15th February repo roll was accomplished with little change. The 25th February repo roll was also achieved. A Board meeting was held on 27th February at which, after discussion, it was decided the better course was to maintain the capital preservation strategy. Because of the increased signs of market volatility over the preceding two weeks, the Independent Directors approved a proposal from Management to extend the suspension of the Investment Guidelines until 30th September 2008.
44. By the end of February the financial position had deteriorated. All the unrealised gains achieved since the beginning of the year had turned into \$17m in losses. The Liquidity cushion had reduced to 11.3% although haircuts had remained reasonably steady at a weighted average of 2.7% spread between 14 repo lenders.
45. However, almost immediately after that Board meeting, markets began to worsen further. Repo lenders had made substantial write-offs and were short of liquidity. On 5th March CCC received a new round of margin calls from its lenders and that evening received its first ever notice of default from a lender. On 6th March it received margin calls of more than \$400m in a single day and was unable to meet them. It proved impossible to resolve matters and on 17th March, an order was made in the Royal Court for the compulsory winding up of CCC. The Lieutenant Bailiff found that the immediate cause of CCC's collapse in early March 2008 was the unforeseen systemic liquidity crisis among the banks and the run on repo which this caused.
46. CCC's net deficiency (although the claims are awaiting ultimate confirmation as debts) has been quantified at more than \$350m.

The claims at trial

47. The Appellants brought claims against the Respondents under a number of headings:-
 - (i) They alleged that from the time of the Board meeting on 26th July 2007 onwards until CCC's failure in March 2008, the directors were in breach of their duty to exercise reasonable skill and care in managing CCC's business. In particular, the 'core breach' (as the Lieutenant Bailiff termed it), of the directors was said to be "*failing to insist that CCC either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down*". The parties seem to have concentrated on (i) of the core breach, namely that the directors should have sold RMBS at the rate of \$2.5bn to \$3bn per month from September 2007 onwards. [1413] [1414] and [1377].

- (ii) They alleged that the directors were also in breach of their fiduciary duty owed to CCC. That fiduciary duty included a duty to act in good faith in the best interests of CCC, not to act for collateral improper purposes, to exercise their own independent judgment in relation to CCC and not to act in relation to the affairs of CCC where there was an actual or possible conflict between their duties to CCC and any duty owed, for example, to the Carlyle Group. The key allegation made strongly by the Appellants was that the directors had taken decisions in the interests of Carlyle rather than of CCC. [369].
- (iii) They alleged that CIM was in breach of contract and/or liable for the tort of negligence in connection with the performance of its duties as investment manager. The terms of the contract between CCC and CIM exempted CIM from liability unless guilty of ‘gross negligence’. It was alleged that CIM’s negligence in the performance of its duties amounted to gross negligence. The gross negligence alleged mirrored the ‘core breach’ alleged against the directors. [614-5]
- (iv) They alleged that the directors were liable for wrongful trading in that at various times before CCC went into insolvent liquidation, the Board knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation. [589].
- (v) They alleged that CIM and two other Carlyle companies (referred to as the “Entity Defendants”), by reason of their relations with CCC and the power and influence which they exercised over it, were either ‘shadow directors’ or ‘de facto directors’ of CCC and they therefore owed to CCC the duties of an actual director. [23].
- (vi) Finally there was a secondary alternative claim against the Entity Defendants in unjust enrichment which related principally to the return of the management fees paid by CCC to CIM. [618]

Together with compound interest up to the date of the hearing, the total claim was just under \$2bn. [24].

The judgment in outline

48. The Lieutenant Bailiff summarised the legal principles applicable to the various causes of action at [349] – [767] of her judgment. In relation to the standard of skill and care required of a director, there appears not to have been any dispute. At [501] she said:-

“It is of course common ground that there is such a duty and the formulated standard of care is also common ground. It is that of a reasonably diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as those of the relevant director with regard to the company and (b) the actual knowledge, skill and experience of that director...”

49. She went on at [511] and [512] to agree with the proposition that:-

“... a director will be in breach of his duty of skill and care only if the court is satisfied that no reasonably diligent director with the material degree of knowledge, skill and expertise could have acted in the way in which the particular defendant director did...The point is that the court must be satisfied that the decision complained of went beyond a mere error of commercial judgment.” [original emphasis]

50. The Lieutenant Bailiff also held that the duty of skill and care owed by CIM under its contract was materially indistinguishable from the duty of skill and care resting on a director of CCC with the relevant increased material expertise, being that of Mr Stomber who was the key individual acting on behalf of CIM. [1276].
51. The Lieutenant Bailiff heard evidence from all the directors as well as other witnesses and she summarised her assessment of the witnesses and their evidence at [828] – [928]. She also summarised her assessment of the expert witnesses at [950] – [1076].
52. The Appellants had grouped their alleged breaches of duty and other claims by reference to five successive periods, namely July 2007, August 2007, September 2007, October – December 2007 and early 2008. The judgment therefore deals with each of these periods separately. In respect of each period, the Lieutenant Bailiff summarised her factual findings as to what had occurred. She then summarised the arguments put forward by the Appellants and the Respondents respectively in respect of that period before setting out her conclusions and the reasons for those conclusions.
53. In view of the limited nature of the appeal, it is not necessary to set out her findings in respect of each period. The appeal concentrates upon certain aspects in relation to the period September – December 2007 and we shall refer as necessary later in this judgment to the Lieutenant Bailiff's conclusions in respect of that period.
54. As indicated at the outset of this judgment, the Lieutenant Bailiff dismissed all the claims. In particular:-
 - (i) She held that the decisions and actions of the Directors which had been relied on by the Appellants as being breaches of fiduciary duty or of the duty of skill and care were all decisions or actions within the range of decisions or actions which a duly diligent, skilful, conscientious and loyal director of CCC (having, in any individual case, any enhanced level of skill actually possessed by such individual defendant) might reasonably have made in all the material circumstances at the time. Indeed she went further and said that she was satisfied that the individual directors each applied proper and appropriate skill and care in taking the material decisions and actions and had been acting in the belief, and in good faith, that the relevant decisions and actions were in the best interests of CCC, including where appropriate the material interests of CCC's creditors. She found that there was no material deficiency in the processes by which the material decisions were taken having regard to all the circumstances of the case. She considered in respect of each of the relevant periods whether it was reasonable to continue the capital preservation strategy or whether CCC should have attempted to sell RMBS as alleged by the Appellants. She concluded in respect of each period that the decision to continue with the capital preservation strategy (and therefore not sell RMBS) fell within the range of reasonable decisions in the circumstances.
 - (ii) For much the same reasons, she dismissed the claim that CIM was in breach of contract in relation to its investment management activities or in breach of any tortious duty of care.
 - (iii) The claims of wrongful trading against the directors failed because she was satisfied that at no time prior to a few days shortly before CCC was actually placed in insolvent liquidation in March 2008 (which were immaterial) did the directors conclude, nor ought they reasonably to have concluded, that there was no reasonable prospect that CCC would avoid going into insolvent liquidation.

- (iv) She rejected the claim that any of the Entity Defendants had acted as a ‘shadow’ or ‘de facto’ director.
55. The nub of the Lieutenant Bailiff’s conclusions are perhaps summarised at [2640] of the judgment:

“In a nutshell, CCC’s original business model was reasonable. The liquidity cushion built into that model had operated as intended and in fact helped CCC to survive an even worse financial crisis than the notorious LTCM crisis of 1998. CCC’s directors then made judgements to enable CCC to try to regain health and strength which were reasonable at the time. CCC failed because the depth of the weaknesses in the financial markets was so great that those weaknesses came to threaten, not merely the profits of major investment and commercial banks, but their very viability, and hence to cause a systemic withdrawal of what had previously been a very normal, stable and reliable form of finance. CCC’s directors did not appreciate the depth of this instability, but in this they were in wide and good company. To suggest that there was anything that they, or CIM, clearly ought to have done significantly differently from July 2007 until CCC’s eventual collapse in March 2008 is, in my judgment, being entirely wise with hindsight.”

56. The Lieutenant Bailiff went on to hold that even if she was wrong about the directors and/or CIM not being in breach of duty, the Appellants had not proved any loss or damage consequent upon those breaches. They had failed to satisfy her that, if the Respondents had made the decisions and taken the actions which the Appellants claimed they ought to have done, CCC would thereby, on the balance of probability, have avoided any part of the losses which it in fact sustained upon its liquidation in March 2008.
57. Finally, the Lieutenant Bailiff dismissed the alternative claim in unjust enrichment.

This Appeal

58. As stated previously, the Appellants appeal on limited grounds. They do not seek to challenge the Lieutenant Bailiff’s decision to dismiss their claims for wrongful trading, unjust enrichment or against the Entity Defendants as ‘shadow directors or ‘de facto directors’; nor do they pursue their claim for breach of fiduciary duty against the directors other than against the three Independent Directors.
59. Furthermore, they do not appeal against the Lieutenant Bailiff’s decision that there was no breach of duty by the directors or CIM in respect of July or August 2007. In other words, they proceed on the basis that the decision in August to adopt the capital preservation strategy was within the band of reasonable responses to the position which the directors faced. They confine their appeal to asserting that CCC should have sold \$7.8bn of RMBS from October 2007 onwards with a view to reducing the risk of default and achieving a 40% liquidity cushion by the end of 2007; and that the Lieutenant Bailiff was wrong to find that the failure to do so was not a breach of the duty of skill and care. Linked with this is an assertion that the Independent Directors were in breach of fiduciary duty by agreeing to suspend the Investment Guidelines on 1st October 2007 and extending that suspension on 13th November 2007.
60. They assert that the Lieutenant Bailiff made a fundamental error when she held that any reasonably competent director would have perceived that there were very significant risks in selling RMBS at this time, which could be highly unpredictable and potentially disastrous. They contend that there was no evidence upon which the Lieutenant Bailiff could properly make such

a finding and that, when that finding is removed, selling RMBS was the obvious thing to do and it was a breach of duty not to do so.

61. The essence of the approach as set out in the three preceding paragraphs of this judgment, therefore, is that the Appellants no longer insist upon the panoply of propositions and arguments which they deployed at trial but, rather, restrict their appeal to a focus upon an element which, in their submission, appears to be the foundation for the finding of the Lieutenant Bailiff against their case of breach of duty: namely, her finding that evidence supporting a case for the Respondents as regards unacceptable levels of risk in selling RMBS is an answer to the contention that RMBS should have been sold from October 2007 onwards.
62. Because of that focus and the arguments now prayed in aid, it may be important to reflect, briefly, on the history of the appeal.
63. It is important to be aware that the present Case for the Appellants was presented as a result of significant deletion and amendment in May 2018 of the Notice of Appeal of December 2017. That initial notice of appeal was extensive. This might be seen as consistent with what had been an extensive trial by any standards. As the Lieutenant Bailiff noted at [39] – [56], not without pointed observations, the trial had been scheduled for 85 court days and in fact occupied 67 sitting days. The Plaintiffs' pleadings in the Cause as finally presented ran to 252 pages. The Defences and Counterclaim for the various sets of Defendants ran, in total, to some 574 pages. Written Closing Submissions ran to hundreds of pages and oral Closing Submissions took many days. In consequence, the Appellants' initial Notice of Appeal ran to some 56 pages. Of those, some twelve pages were devoted to grounds of appeal set out under the aegis that the Lieutenant Bailiff had applied the wrong test in the wrong way to the facts. A further six pages were devoted to grounds under the aegis that the Lieutenant Bailiff had wrongly concluded that the avoidable resulting loss from the alleged breaches of duty was no more than a remote speculation.
64. One of the elements of the first of those grounds of appeal was that, in the circumstances, decisions taken on 23 August 2007 required re-evaluation (Notice at Annex paragraph 28), that such a re-evaluation would have demonstrated that the benefits of selling RMBS far outweighed any risks (Notice at Annex paragraph 32), and that the Lieutenant Bailiff had had insufficient regard to (i) the contemporaneous evidence that significant quantities of RMBS could have been sold at an acceptable price and (ii) the absence of contemporaneous documentary reference to risks of selling (Notice at Annex paragraphs 43 and 53 to 62).
65. In the Amended Notice, the negligence grounds are presented within four pages. They are presented within a very narrow compass and contend, in short:
 - (i) that the Lieutenant Bailiff wrongly overlooked, mischaracterised or misunderstood the contemporaneous evidence and failed to test evidence and conclusions against inherent probabilities;
 - (ii) that the Lieutenant Bailiff therefore wrongly found that any reasonably competent investment manager or director would have perceived that there were very significant risks in selling RMBS;
 - (iii) that the Lieutenant Bailiff therefore wrongly found that risks of selling were a relevant factor to be weighed in the balancing exercise to be performed in deciding whether to sell RMBS;
 - (iv) that the Lieutenant Bailiff should have found that any reasonably competent investment manager or director would have perceived by October 2007 that a

substantial quantity of RMBS could have been sold at repo prices or above without significant risk; and

- (v) that the Lieutenant Bailiff should have found that the crux of the balancing exercise to be performed involved weighing the gravity of CCC's financing risk against the recognition of capital losses to CCC arising from sales of RMBS, and that the alleged perceived risks of sales were not a relevant factor.

66. The Appellants contended that the fundamental error which had been made by the Lieutenant Bailiff was to misunderstand the true position of the directors as regards the ambit within which they were prepared to sell RMBS between August and December 2007. This error, it was contended, affected the entire edifice of the reasoning of the Lieutenant Bailiff. This was because the undoubted premise underlying her finding that the directors were not negligent in failing to sell RMBS was that any reasonably competent investment manager or director would have perceived that there were significant risks in selling RMBS and that those risks outweighed any advantages. The Lieutenant Bailiff had found that the risk of moving the market downwards by selling was *"well-recognised and very major"* and could *"snowball adversely"* [1766]. The risk of being perceived as a distressed seller, to which CCC was vulnerable, *"could be very damaging, and indeed potentially disastrous, both as to the terms of any sales achievable and (more importantly) as to consequential effects for them in the market."* [1781]. On this point the Lieutenant Bailiff had concluded: *"Concern about highly unpredictable and disadvantageous consequences from selling RMBS in any quantity was thus, I find, not unreasonable."* [1782].

67. Those findings and remarks by the Lieutenant Bailiff were set out in the 'Risks of selling' section of the judgment in which she looked at various factors which appeared to be material to investment management decisions. In the preceding 'Price' section the Lieutenant Bailiff had, correctly, stated *"the price which CCC might reasonably expect to realise from selling its RMBS is obviously of central importance to the question of the reasonableness of deciding not to sell."* [1735].

68. The Appellants submitted that the key findings which underlay the Lieutenant Bailiff's premise that very significant risks in selling RMBS would have been perceived were the following:

"I find that all the evidence points to it being a reasonable working prediction that on selling any significant quantity of RMBS, CCC could not expect to achieve better than current secondary market pricing levels, ... There was also a significant possibility that it might not, in the event, even be able to achieve that." [1758].

"The upshot of all this is that I am satisfied that the overwhelming preponderance of the evidence is that the creation of a liquidity spiral, or repo feedback loop, by attempting to sell into an adverse market when dependent on slim liquidity, was a well-recognised and very major risk." [1766].

"Having reviewed all the evidence, I am satisfied that it was both objectively the case, and a reasonably subjective perception for CCC, that the consequences of being perceived to be a distressed seller could be very damaging, and indeed potentially disastrous, both as to the terms of any sales achievable, and (and more importantly) as to consequential effects for them in the market." [1781].

69. For the Appellants it was submitted that such findings and others were interrelated. For example, findings as to the risk of being perceived to be a distressed seller ([1767], [1768], [1770], [1781] – [1782]) underpinned the finding that there was a significant possibility that CCC could not even sell at secondary market prices ([1750], [1752], [1753], [1755]).

70. The principal argument supporting their contentions that such findings were plainly and obviously wrong, was that the Lieutenant Bailiff had overlooked, mischaracterised or misunderstood compelling contemporaneous evidence that was contrary to her findings as to risk. In preparing the way for this argument, the Appellants laid stress on the need to understand the different price measures referred to in evidence and in the judgment. These were:
- 'IDP prices': being the prices obtained from the third party pricing agency known as "IDP" or "FT". [105], [1740].
 - 'Secondary market prices': being prices at which transactions were occurring through the onward sale of existing bonds which had previously been created by a relevant Agency or dealer and first sold as a new issuance. [1717]. Any sales by CCC would have been in this secondary market in which transactions are individually conducted rather than being carried out on an Exchange. As private bargains they can go unrecorded in public information and are not necessarily widely noted. [1717].
 - 'Repo prices' or 'repo marks': being the prices at which repo lenders value packages of RMBS held by them as collateral for loans to parties such as CCC. Such prices were set by reference to information from the repo lenders' trading desks and were not necessarily directly linked with or referable to IDP prices. Up to July 2007, lenders generally used the IDP/FT pricing agency prices. [106]. Thereafter, however, lenders set their own prices at a level lower than IDP prices. [1742].
 - From about August 2007, IDP prices were generally higher than secondary market prices and secondary market prices were generally higher than repo prices. [1740] – [1742].
71. Bearing those distinctions in mind, the Appellants submitted that the Lieutenant Bailiff's findings on perceived risks of selling were quite inconsistent with contemporaneous evidence. First, on 20th August 2007, CCC's investment committee had approved the sale of at least \$4 billion of CCC's RMBS at or above 'repo prices', if a sale on those terms could be achieved; and shortly after that approval CCC's Board had agreed, on 23rd August that sales at or above 'repo prices' would be beneficial. This evidence was not reflected in [1325] of the Judgment where the Lieutenant Bailiff had found that the investment committee had ***"agreed that if CCC could obtain a fair price for its Agency RMBS at or around its existing marks, then it should pursue a sale to JP Morgan of up to (say) \$4 Bn of Agency RMBS in order to generate additional liquidity."*** (Emphasis added). As was submitted for the Appellants, the reference to "its existing marks" was clearly a reference to IDP prices used by CCC to value its portfolio and not to repo prices. The evidence had been clear that the meeting on 20th August had approved a sale at repo prices at a time when the directors were well aware that repo prices were lower than IDP prices.
72. Second, as part of the third quarter 2007 review of CCC's financial statements for the nine months ended 30th September 2007, CCC's auditors (PwC) considered whether the recent liquidity crisis had indicated that CCC might be unable to continue as a going concern for a reasonable period of time. Asset valuation was a central issue and the view held by CCC and independently verified by PwC was that RMBS should be valued at IDP prices in the accounts. CCC's financial statements had been issued by the directors on that basis. The Appellants contended that this meant that the directors (and PwC) believed that IDP prices could be achieved on a sale; otherwise the financial statements would not present a true and fair view of CCC's financial position.
73. Third, between late September and mid November 2007 CCC's board and auditors accepted as achievable a "Downside Case" which reflected on market activity and assumed that, if market conditions deteriorated, CCC could sell \$4 billion in RMBS at or around repo prices within seven

weeks. The Downside Case had explicitly assumed that there would be no change in repo prices in that period in other words, that there would be no downward spiral for RMBS as a consequence of an ongoing sale at or about repo prices in deteriorating market conditions. The Lieutenant Bailiff had mischaracterised the Downside Case as theoretical, illustrative and hypothetical. [2035], [2174], [2230]. The existence and use of the Downside Case established both that the directors perceived that CCC could make such sales in deteriorating market conditions and did not fear any risks. The preponderance of the evidence had been that the Downside Case was conceived, prepared and presented to PwC, and accepted by PwC, as a reliable, realistic and achievable analysis.

Scope for the Appellate Court to interfere with the judgment below.

74. Given the nature of the appeal, as set out above, it will be appreciated that this appeal is unusual in its ambit. In essence, the Appellants seek to identify certain very specific failures on the part of the Lieutenant Bailiff, being findings in fact said to be unsupported by evidence. A review, therefore, is sought in the nature of a rehearing, or partial rehearing, whether by this court or by the court of first instance.
75. As this court has stated recently, it is well recognised that, in general, an appellate court will not interfere with a finding in fact by a court of first instance where there has been an evidential basis which, if accepted, could have founded the determination of that fact: Investec Trust (Guernsey) Limited and Others v Glenalla Properties Limited and Others [2015 GLR 300] at paragraph 108. Separately, even when an appellant is able to point to a finding in fact unsupported by relevant evidence, if the overall factual determination which leads to the court's findings in law is able to be supported by the evidence led, a failure in respect of one or more findings in fact will not necessarily result in the appellate court interfering with the determination.
76. Here, however, the Appellants seek to identify, first, that there was a critical misunderstanding which infects the whole of a relevant body of evidence and, second, that findings in respect of expert evidence were not properly tested by reference to evidence as to what was taking place at the relevant time.
77. The present case, therefore, may fall within one of the very restricted number of instances when an appellate court may interfere with a primary finding of fact or an inferential finding and, thereby, identify that the decision below is one which no reasonable judge could have reached, upon a proper appraisal of the facts and properly instructed as to law. The examples given in the judgment of Lord Reed JSC in Henderson v Foxworth Investments Limited and Another [2014] 1 WLR 2600, at paragraph 67 are instructive. There his Lordship, after considering the authorities, confirmed that it is permissible for an appellate court to interfere with the findings of fact made by a trial judge, not only if satisfied that the decision cannot reasonably be explained or justified, but also in cases of identifiable error, including the making of a critical finding of fact which has no basis in evidence, or a demonstrable misunderstanding of relevant evidence, or a demonstrable failure to consider relevant evidence.
78. Even so, it is important to bear in mind two other judicial pronouncements which may be of importance to the matter presently before this court. As indicated by Clarke LJ in Assicurazioni Generali Spa v Arab Insurance Group [2003] 1 WLR 577, at paragraph 12:

"... in cases in which the court was asked to reverse a judge's findings of fact which depended upon his view of the credibility of the witnesses, it would only do so if satisfied that the judge was plainly wrong."

79. Separately, in Biogen v Medeva Plc [1997] RPC 1, at page 45, Lord Hoffman stated:

"Where the application of a legal standard such as negligence or obviousness involves no question of principle but is simply a matter of degree, an appellate court should be very cautious in differing from the judge's evaluation."

80. The present case, therefore, is one of those in which, given the nature of the points raised on appeal, it is important for the appellate court to bear in mind, first, that a trial judge, after a lengthy and complex trial, will, in general, be in a much better position than an appellate court to understand where, as a matter of the logic which appeared to her or him applicable to the case, each piece of evidence fits together with the others and supports the ultimate determination. In the second place the appellate court should recollect that a lengthy and complex trial might conceivably allow an occasional matter either to be overlooked by the trial judge or its proper relationships with the remainder of the evidence to be misunderstood. The test for such an appellant is a high one, but if there has been a material error, the appellant is entitled to detailed consideration as to how it is to be taken into account.

Discussion on the Appeal

(i) *Misunderstanding the position of CCC as at August 2007*

81. In our judgment it is clear from the terms of the judgment below that, in [1325], the Lieutenant Bailiff used the words "its existing marks" to refer to IDP prices as opposed to repo marks. Whilst Advocate Swan for the Respondents continued to suggest that the phrase was open to construction, we did not understand him seriously to argue the contrary.

82. Prior to its appearance in [1325] there is little reference to "marks" in the judgment. Neither the word "mark" nor the word "marks" is a defined term. In the appropriate context the word "mark" appears first in [203] where the Lieutenant Bailiff said this:

"This price, or value, of the securities is commonly referred to in financial markets as their "mark". This is because market participants habitually review the value of their securities as against apparent market prices, doing this even as frequently as daily, and "mark them to market" (hence "MTM")."

83. The word "marks" appears in [260] in context; but in a very general sense. Then in [1319] the Lieutenant Bailiff stated *"It appears that Citi and Lehman agreed to maintain 2% haircuts, although as Lehman were now setting their own marks, this rather negated the direct beneficial effect of this for CCC."*

84. It therefore follows that, as used in [1325], the words "its existing marks" lack absolute precision; albeit they refer to CCC's own marks at the time in question. It is clear from the remainder of the paragraph, however, that what the Lieutenant Bailiff had in mind was *"a fair price and without sending a risky and troubling message to the market about CCC's liquidity;"*.

85. When that latter part of [1325] is read in conjunction with [1761] in the "Risks of Selling" section, it is clear that, in the mind of the Lieutenant Bailiff, a sale "achievable at a fair price and without sending a risky and troubling message" meant a sale at or about IDP or other actual secondary market prices as opposed to repo prices. At [1761] the Lieutenant Bailiff said:

"The risk of selling was that in executing a transaction, even a small sized transaction, CCC would provide evidence of price and thus apparent value. If this were below current prices, (whether IDP or other actual secondary market prices), this evidence could and obviously probably would be used by repo lenders to justify marking down the already marked down repo value of CCC's other similar securities still further, potentially producing an immediate margin call and subsequently producing an increased effective haircut as against CCC's own price marks, these broadly remaining at IDP prices."

The price band immediately below IDP and secondary market prices was repo prices.

86. In a judgment in all other respects of compelling persuasion by reason of its attention to detail throughout a most complex litigation and of its presentation, both in terms of structure and language, so as to be readily understandable, it was perplexing to us initially how such a significant misunderstanding could have arisen in the mind of the Lieutenant Bailiff: if, indeed, the evidence were so clear that as at 20th to 23rd August the directors were content for there to be a sale at or about repo marks.
87. That the reference should have been to "repo marks" was accepted on behalf of the Respondents by the conclusion of the hearing before us. Taking only the evidence of Mr. Stomber, his evidence in cross examination taken together with his witness statement made it clear that the marks in question were "repo marks".
88. Given what was otherwise a judgment prepared with exceptional care, we required the parties to provide as much detail as possible as to how this error could have occurred. We now record the principal strands in the parties' submissions below which, in all probability, gave rise to this error. As will be seen, the error arises from submissions made on behalf of the First to Fourth Respondents. In setting out these matters we do not consider that any aspersion whatsoever falls to be cast either at the Lieutenant Bailiff or at the Appellants for failing to identify the inconsistencies between submission and evidence. In a case of such complexity as this, the focus of parties and Lieutenant Bailiff during the period of submissions may require to fall on a great multitude of issues and it may only be, as it appears here, once the line of argument of the written judgment at first instance becomes clear, that the critical importance of a particular point becomes manifest.
89. The points which now follow are also of importance in laying aside any doubt as to what the Lieutenant Bailiff had in mind in the reference to "its existing marks" in paragraph [1325].
90. Looking first at the Written Closing Submissions of the First to Fourth Defendants, it is clear that, when reference was being made to "CCC's marks" the intention – either expressly or by inference – was to indicate IDP prices.
- a. In dealing with the cross examination of Mr. Stomber in respect of the views being expressed as at 20th – 23rd August, the Submissions stated: ***"If CCC could have sold its entire portfolio at IDP prices even over an extended period, the benefit would be obvious – although significant losses would still have been incurred. So it was that Mr. Stomber recommended a sale of \$4 billion of floaters in August 2007, if it could have been done at a price that made sense, which is to***

say at CCC's marks." (Emphasis added). The close juxtaposition and reference to "a price that made sense" clearly suggests that "CCC's marks" were "IDP prices". The Respondents accepted, however, that, although the portions of Mr. Stomber's oral evidence cited at this point did not indicate beyond doubt what "marks" he was referring to, his witness statement had made it clear that he was referring to "repo marks". They accepted that the reference to "IDP prices" in this passage at the very least introduced the potential for confusion.

- b. A later passage in the Written Closing Submissions refers to the evidence of Mr. Hance on day 22 in the following terms: *"(We were open to the idea of selling RMBS at our marks, and, you know, to constantly monitor that.) The crucial question was whether sales could be accomplished at acceptable prices, that is to say, at or about CCC's marks, thereby generating sufficient liquidity and minimising the risk of a further devaluation of CCC's portfolio."* The Respondents accepted that, in this passage, the phrase "CCC's marks", viewed in the light of the Respondents' submissions generally, was intended to be a reference to IDP prices.
- c. In proceeding to deal with the views of the Investment Committee at 22nd-23rd August, the Written Closing Submissions said this: *"The Committee supported the sale insofar as it could be completed at or close to CCC's marks. (Stomber) {Day 18/29: 21-23} ("I would first go back to the board and tell them where I can get [it] done at and then with the recommendation, if we can do it at our mark, we should sell."); (Hance WS para 222) {G/3/66} ("I supported the proposed sale [at CCC's marks] even though it meant CCC would realise losses.")* The Respondents accepted that the first reference to "CCC's marks" should have referred to "repo marks". As to the purported quotation from Mr Hance's witness statement, we consider the insertion of the expression 'at CCC's marks' to have been grossly misleading. The relevant passage of Mr Hance's witness statement read as follows:- *"At least on this, I would have understood that Mr Stomber intended CCC would sell \$4 billion of assets at the repo marks (and thus received back the full amount of its 2% haircut since 2% of \$1 billion is \$20 million). I supported the proposed sale on this basis even though it meant CCC would realise losses."* It is quite clear from this passage that when referring to 'on this basis', Mr Hance was referring to the basis set out in the previous sentence, namely sale at repo marks. The Respondents' substitution of 'at CCC's marks' for 'on this basis' misrepresented the evidence which Mr Hance had given.

91. It seems clear that these passages became the foundation of the written Factual Chronology prepared by the Defendants for closing submissions. At paragraph (405) it is stated: *"Messrs Conway, Hance, Stomber and Zupon agreed, however, that if CCC could obtain a fair price for its Agency RMBS at or about its existing marks, then it should pursue a sale to JP Morgan of at least \$4 billion of Agency RMBS in order to generate additional liquidity. They believed that a quiet sale, pursued through a single dealer that was not one of CCC's repo lenders, might be able to be accomplished at a fair price without sending a troubling message to the market about CCC's liquidity (even though it would mean realisation of losses)."* This passage is repeated word for word – with only the most minor and insignificant alterations – in the leading sections of [1325] of the judgment.
92. If further support was required for confirmation of the position which the Defendants wished to put forward in their chronology, it is found at [418] of the written Factual Chronology which stated: *"The Plaintiffs criticise CCC's Management for failing to attempt to negotiate with JP Morgan for a better price on the potential transaction. Given the extreme*

divergence between the price quoted by JP Morgan and the price at which CCC was willing to sell (namely, its marks or IDP prices), it is far fetched, at best, to suggest that an acceptable price could have been obtained through a mere "negotiation"."

93. Turning to the oral closing submissions on behalf of the First to Fourth Defendants, one passage in particular is noteworthy in again confirming the position which the Defendants sought to adopt in respect of the evidence. During Day 65, in a passage expressed with firmness and clarity, Advocate Swan for those Defendants stated "... ***but the point which the plaintiffs make that the defendants were simply not prepared to countenance any sale with a loss won't stand up in the face of the evidence that they were prepared to sell \$4 billion worth of these assets to JPM if they could get their marks which would realise the loss of the difference between par and IDP.***" Whilst Advocate Swan submitted to us that the reference here to "***their marks which would realise the loss of the difference between par and IDP***" was a misstatement, the impression to be given to the Lieutenant Bailiff was entirely consistent with the passages in the Written Closing Submissions and the Factual Chronology to which we have just referred.
94. Having regard to the unremitting tenor of these passages in the submissions for the Defendants, we are left in no doubt but that the passages in the judgment to which we have referred to above, principally [1325] show that, in the mind of the Lieutenant Bailiff, the nature of a sale which "***might be achievable at a fair price and without sending a risky and troubling message to the market about CCC's liquidity***" was a sale at IDP prices; whereas, upon the basis of the evidence, as it is now accepted, that view should have been expressed by reference to a sale at repo prices. It follows, in our judgment, that the findings of the Lieutenant Bailiff as to perception of risk were based upon a misunderstanding, in that her conclusion in the latter part of [1325] should have indicated that the directors did not perceive a substantial sale at or round about repo marks to be something which would send out "***a risky and troubling message to the market***".
95. However, the existence of such an error does not, in our judgment, have the result that the issues are at large for determination by this court or that the case must be sent back for even a partial retrial. Were findings to have been made (i) that CCC was prepared to sell a material tranche of RMBS in August 2007 at or about repo prices, (ii) that CCC was not at that point concerned that such sales would send a damaging message to the market and therefore (iii) that such sales could have been undertaken without risk, they would not, in themselves, lead ineluctably to a conclusion that the relevant defendants were in breach of their duties as directors. Nor, taken with the other issues on which we were addressed, would such a result obtain, for the reasons to which we now turn. Before doing so we would add, for the avoidance of any doubt, that we see nothing in the circumstances before us which suggests an attempted fraud by the Respondents. Here there was no false evidence or document from the Respondents. On the contrary their witnesses all gave honest evidence. Whilst we regard the misrepresentation on the part of the representatives of the Respondents as incompetent and wholly unacceptable, we have considered the explanation as to how the misrepresentation may have occurred and we do not find it to have been an intentional or deliberate act on the part of the Respondents.
- (ii) *Whether the Liquidity Guideline was imperative*
96. It is an inevitable concomitant of the Appellants' argument that failure to engage in sales in late 2007 would constitute a breach, that adherence to the Liquidity Guideline had to be an imperative and, in consequence, that there was no room for the directors to choose a different route in circumstances where sales could be carried out without sending a damaging message to the market.

97. As the Lieutenant Bailiff found at [161] and following, in September 2006 CCC issued a Preliminary Confidential Private Placement Memorandum (the "PPM") for the purpose of seeking commitments from investment banks. The PPM set out CCC's then intentions as regards placement. Whilst the eventual PPM, issued in December 2006, was in slightly different terms, each of the documents set out CCC's investment objective, proposed management and investment strategy. As the Lieutenant Bailiff found at [168], the PPM warned that the company could change its investment strategy as and if it saw fit, but also stated that there would be "*Investment Guidelines*" approved by the board. It made clear that these could be changed but that they had to be approved by a majority of the Independent Directors. One of the central guidelines identified was the maintenance of a liquidity cushion of 20% of capital, to meet possible margin calls.
98. As the Lieutenant Bailiff found, it was always intended that there would be a public offering of shares in CCC. Eventually this was set in motion in June 2007, completed in July 2007, and thereupon CCC was listed on the Euronext Exchange. Again, the business model was explained in the Offering Memorandum (the "OM") published with the offer.
99. As the Lieutenant Bailiff found at [292] and following, the OM was long and elaborate (as was only to be expected) and contained all of the information set out in the PPM. The OM included the Investment Guidelines as they then stood together with a description of the liquidity cushion. It noted that amendment of the Guidelines required the approval of the Independent Directors but, in addition, that this could be done without notice to shareholders. Among other matters, the risk disclosures noted potential adverse effects which could be magnified through the extensive use of leverage.
100. In particular, at [293] the Lieutenant Bailiff noted that the risk disclosures in the OM warned that a decrease in the market value of CCC's securities could have significant adverse consequences and that in unusual market conditions the liquidity cushion, which had been designed to meet reasonably foreseeable margin requirements, might prove to be insufficient.
101. We have considered the Guidelines, the PPM and the OM and note the importance of these points highlighted by the Lieutenant Bailiff. It seems to us clear not only that the Guidelines themselves identify that, with approval, they may be altered but also that this was highlighted in the PPM and OM. Further, at least as far as the public were concerned, the OM had made clear that alterations to the Guidelines could be effected through approval of the Independent Directors and without notice to shareholders.
102. Upon the basis of these findings, in our judgment, observation of the Liquidity Guideline was not an imperative in any sense. The directors, both in their own minds and in addressing potential investors, had in mind the potential for significant volatility of investment conditions and the magnification of the effect of that volatility when using leveraged finance. A liquidity cushion support mechanism was to be put into place but might, in the event, prove to be insufficient. There are numerous scenarios which might arise upon the liquidity cushion being found to be insufficient, but it is not necessary to speculate upon those. What is manifest, as regards the Guidelines, is that the 20% cushion could be departed from upon appropriate approval being obtained. In other words, unusual market conditions might be encountered, the response to which ought to be allowed to include alterations to the Guidelines. There is nothing in the Guidelines, the PPM or the OM to suggest that, so long as assets could be sold without sending a damaging message to the market, the response of the directors to an impairment of the liquidity cushion had, of necessity, to be that the cushion should be replenished before any other strategies or objectives could be considered.

103. It therefore follows that failure to maintain the liquidity cushion by replenishing it as the primary response to impairment cannot be seen, in itself, as a breach of duty on the part of the directors. Manifestly, the creation of a liquidity cushion was considered an important safeguard; but it could be departed from and whether there had been a breach of duty to exercise reasonable skill and care would depend upon consideration of all the relevant facts and circumstances.

(iii) *Other issues relating to alleged Breach of Duty*

104. Although, as we have explained, there was in our view no overriding imperative to restore the liquidity cushion, it is nevertheless necessary to give further consideration to the Appellants' case on breach of duty. We note that there was no suggestion that the judge had applied the wrong principles. We reiterate that the Appellants' case on the appeal was that the first to eighth defendants should, from September 2007, have sold RMBS to the value of \$7.8 billion in order to achieve a 40% liquidity cushion by the end of 2007. It was said that, once it was understood that (contrary to the Lieutenant Bailiff's finding) the directors did not believe that sales would result in a catastrophic downward price spiral, "selling RMBS was the obvious thing to do". It was that failure that was said to amount to negligence, alternatively to wilful neglect or default, by the first to seventh defendants, also to breach of fiduciary duty by the fifth, sixth and seventh defendants, and to gross negligence by the eighth defendant. In each case, there was said to be a breach of duty owed to CCC.

105. In essence, the Appellants' contention is that, even if there was no absolute requirement to restore the liquidity cushion, it was a breach of duty not to do so by selling RMBS. For the reasons we now set out, we reject that contention.

106. We start by reminding ourselves that there is now no criticism of the adoption of the capital preservation strategy in August 2007. There is no appeal from the Lieutenant Bailiff's findings in that regard, summarised at [1598] as follows:-

"At the Board Meeting of 23rd August 2007 the Defendants had made or approved a decision not to sell RMBS but rather to liquidate credit assets, withdraw from commitments to purchase other assets, take a loan from TCG, and not to sell RMBS unless a favourable opportunity arose. I have found that, at that time and in the circumstances, those decisions were no breach of duty by the Defendants, being neither improperly motivated or made for improper purposes, nor being negligent. They were a reasonable reaction to current circumstance, as a matter of proper and responsible business judgement".

107. It follows that the Appellants must establish that the situation had changed after the adoption of the strategy in such a way as to require its abandonment. They seek to do this by saying that once the August crisis was over the obvious and only acceptable course was to sell some RMBS rather than retain them.

108. The Lieutenant Bailiff addressed this question in [2151] as follows in relation to the period up to the end of November 2007:-

"Once it is found, as I find, that the decision taken in September 2007 to implement the capital preservation strategy was itself a reasonable one, the issue with regard to any future date becomes whether the circumstances had changed sufficiently that due skill, care and attention required that decision to be revisited and then changed. I do not, in fact, see the position with regard to repo finance as having materially changed between September and November. The level of difficulty in obtaining it was, it seems

to me, fairly constant. The only material change was that a further two months had elapsed without a restoration of liquidity to the markets, or a notable improvement in obtaining finance, or the value of CCC's assets actually being seen to improve significantly. Given the fact, though, that CCC was solvent with a small but positive cash flow, and that the logic behind the belief that the value and tradability of its assets would improve remained the same, there was reason to consider that this delay or stagnation was something which it was appropriate to try to weather".

109. She addressed it again in relation to the period to the end of December 2007 at [2287] in the following terms (so far as material):-

"I have already found that the Defendants' reactions to the financial circumstance in which CCC found itself prior to December 2007 were not reckless or negligent. This means that the nub of the Plaintiffs' claim as regards December has to be, once again, that in the situation in which CCC then came to find itself the policy of holding RMBS and not selling was so patently the wrong course that it had by then become reckless or negligent. This means judging whether there was any sufficiently significant change in the general assessment of CCC's own financial situation and the impact of surrounding circumstances, which would demand a reappraisal and alteration of the capital preservation strategy. I am satisfied that they did not, whether the circumstances are looked at afresh generally, or only by looking to see if there had been any significant changes in that period".

110. The Appellants claim that these findings are infected by the Lieutenant Bailiff's mistake as to the prices at which CCC was willing to sell in August. The premise underlying this argument is that no reasonable director could have believed (and the directors did not in fact believe) that selling at repo prices would produce a downward price spiral. In our view, the premise is wrong. That is for three reasons.
111. The first reason is that the premise assumes consistency in the repo prices. In fact, however, from August 2007 repo lenders began to set their own marks, which varied from IDP prices to differing degrees. Two lenders – ING and Calyon – continued to use IDP prices throughout. There was accordingly no such thing as "repo prices" applied across the board. If CCC were to sell at the lowest price set by any of its repo lenders, any other repo lender who had adopted a higher price would be likely to conclude that it had overpriced its security. That would result in repricing and a margin call, increasing the demands on CCC's already fragile liquidity. The same would apply to a lesser extent to sales at an average of all the repo prices. Selling at the highest repo price, on the other hand, would have meant selling at IDP prices; but the Lieutenant Bailiff found that CCC could not have sold any RMBS at IDP prices [1756, 1758], and that finding is not affected by her error about the price at which CCC was willing to contemplate sales.
112. The second reason why the premise is wrong is that it depends on the correctness of the proposition that repo prices were distressed prices, in the sense that they represented the lowest price that the RMBS would achieve on a forced sale. As the Appellants put it in their written case at paragraph 148, "*the minimum price at which any reasonably competent IM/director would have perceived that CCC could sell its RMBS even on a distressed sale was the repo price*" (original emphasis). However, that proposition is in our view itself plainly wrong. It is directly contrary to CCC's experience when it explored a sale of up to \$4 Bn Agency RMBS to JP Morgan in August 2007. The average price offered by JP Morgan for CCC's Fannie Mae RMBS was \$97.63, which was 165 basis points (1.65%) below IDP prices and substantially below the \$99.35 at which CCC had marked them in its books [1327]. It was also significantly below average repo prices, which according to appendix CCC-4 to

the report of one of the Appellants' experts, Dr Carron, did not fall below \$98.5 in the second half of August 2007. Moreover, the idea that repo prices represented a "lower bound" was disavowed by Dr Carron in his oral evidence [Day 48/32/19-25]:-

“Q. As an economist, I expect you would accept that the reality is there is no lower bound on the price that CCC might have received if it tried to sell; the price that could be achieved would depend on demand in the market for the particular bond on the particular day that a sale was attempted, wouldn't it?”

A. Certainly that's true.”

113. The third reason is that there was ample expert evidence that selling ran the risk of creating a liquidity spiral. The Lieutenant Bailiff dealt with this at [1766], following an extensive analysis of the expert evidence, in the following terms:-

“The upshot of all this is that I am satisfied that the overwhelming preponderance of the evidence is that the creation of a liquidity spiral, or repo feedback loop, by attempting to sell into an adverse market when dependent on slim liquidity, was a well-recognised and very major risk. This is not least because such consequences, once triggered, are entirely out of the control of the selling party, because they depend on the reactions of third parties, which are in themselves unpredictable, and which can very easily snowball adversely and gain enormous momentum. Embarking on a course which courted this risk would therefore be a very serious decision to make”.

114. In our view, this conclusion is wholly unaffected by the Lieutenant Bailiff's mistaken view that CCC was only prepared to contemplate sales at IDP prices. In the light of the expert evidence, the most that can be said is that CCC considered that it could overcome the risks inherent in selling at repo prices (which, as the Lieutenant Bailiff identified at [1767], included the risk of being perceived to be a distressed seller) if it had to. The risks nevertheless existed, and were understood by CCC to exist. A reasonable director would have had to have taken into account that selling had risks which might not be capable of being overcome.

115. Avoidance of capital losses and the retention of RMBS until their value was restored were key considerations of the capital preservation strategy. At [1670], the Lieutenant Bailiff described the elements of CCC's position in the following terms:-

“Given that CCC's assets were currently priced below par, but would ultimately pay out at par (a financial attribute apparently as inevitable as night following day), selling in the third quarter of 2007, as on the Plaintiffs' case, would create a locked in loss of around \$250Mn which would be avoided if CCC could manage to finance its holdings until their necessary return to par value, or approaching it. Couple that point with the fact that selling would not only crystallise capital losses potentially unnecessarily, but would risk making the immediate financial situation worse..., and the decision not to sell was certainly not unreasonable. The problem for CCC was that the balance of risk against benefit, and in particular the risks of being seen to attempt, or even just prepare, to deleverage by selling RMBS were just too great, or too imponderable, to make it sensible to take any active steps in that direction at any material time.”

116. We take the two considerations in turn.

117. The Appellants contend that “the losses which would be recognised on a sale of RMBS *had already been incurred*” (original emphasis). This, according to them, was because “on sales of RMBS, CCC would simply be substituting one asset with an attendant liability (namely

RMBS with an attendant liability to repay the repo lenders) with another asset (namely cash) of exactly the same net value”. We do not accept this contention. It was common ground that CCC recorded its RMBS in its financial statements at their current value. This meant at IDP prices. The financial statements accordingly showed a loss representing the difference between the purchase price (typically at or close to par) and the current IDP price. This apparent loss would be avoided if the RMBS could be retained to maturity. A sale would, however, crystallise that loss; and a sale at repo prices would incur and crystallise a further loss, representing the difference between the IDP price and the repo price.

118. As to the second point, it was also common ground that the value of CCC’s RMBS would ultimately return to par if they could be held to maturity or earlier redemption of the underlying mortgages. The Appellants say, however, that it was purely speculative whether prices would improve within “the not-too-distant future” (the expression used by the Lieutenant Bailiff at [1844]); and that in any event CCC would have been able to repurchase RMBS at similar prices once it had reduced risk through sales and secured additional funding, so that any loss of opportunity to participate in the future increases of value would have been temporary only. Again, we reject these contentions. CCC’s Agency RMBS carried no credit risk, and so were certain to return ultimately to par value – as was common ground. The evidence of the Appellants’ expert Dr Carron was that it had taken Agency floater prices about six months to recover after the LTCM crisis: see [1839]. There was accordingly a realistic prospect that the value of CCC’s RMBS would recover, even in a relatively short time; and it was obvious that the benefit of that recovery would be lost if the RMBS were sold before the recovery occurred. There was no reason to assume that CCC would subsequently be able to repurchase at similar prices: by the time its own financial position had recovered sufficiently to enable it to start reinvesting, the market would itself have recovered and some of the anticipated increase in value would have occurred. As the Lieutenant Bailiff said at [1882], “if directors are too quick to “cut losses” by selling off assets, they will then be criticised if it should turn out that the losses could actually have been avoided”.
119. A main plank of the Appellants’ argument was that CCC had in fact considered selling RMBS, the assertion being not only that this demonstrated that the directors perceived no risk in doing so but also that, having contemplated selling, they should have gone ahead and done so. Although we view this argument as merely a facet of the arguments that the Investment Guidelines required there to be sales, or at least that no prudent board of directors could have done anything other than sell, we think it worth examining in greater detail the circumstances in which CCC’s expressed willingness to sell occurred. Doing so demonstrates that CCC’s willingness to sell was either a response to extreme circumstances (in the case of the contemplated sale to JP Morgan) or a recognition that extreme circumstances might require reconsideration of the capital preservation strategy (as contemplated in the Downside Case).
120. CCC decided on 20th August 2007 “*that if CCC could obtain a fair price for its Agency RMBS at or round about [repo prices], then it should pursue a sale to JP Morgan of up to (say) \$4 Bn of Agency RMBS in order to generate additional liquidity.... The Investment Committee Defendants came to the conclusion that a quiet sale, pursued through a single dealer that was not one of CCC’s repo lenders, might be achievable at a fair price and without sending a risky and troubling message to the market about CCC’s liquidity*” [1325] – the words “repo prices” replacing the words “its existing marks” mistakenly used by the Lieutenant Bailiff.
121. By the time of that decision, it was evident that CCC’s business was under severe threat from unprecedented turbulence in the financial markets. On 7th August 2007, CCC’s RMBS portfolio declined in value by \$30 Mn, and one of its repo lenders made a margin call of \$70 Mn [1284]. On 9th August 2007, BNP Paribas froze redemptions from three of its hedge funds because of inability to value their holdings of sub-prime RMBS and a “complete evaporation

of liquidity” [1291]. CCC received margin calls on 9th and 10th August 2007, and throughout the week of 13th August 2007, paying out over \$120 Mn in margin in the course of six business days [1296]. In the same period, repo lenders began to abandon IDP prices and make margin calls based on their own prices, as well as to start demanding higher haircuts [1297]. On 13th August 2007 UBS and JP Morgan intimated that they would be seeking haircuts higher than 2% at the forthcoming repo roll on 15th August [1298]. The Lieutenant Bailiff found that “the severity of the liquidity crisis which had developed and was continuing – and which was severely impacting on the immediate availability of sufficient affordable finance for CCC and capable of causing its collapse if not managed effectively – was fully appreciated” [1302]. At the 15th August repo roll CCC retained haircuts at 2%, but left about \$2.6 Bn with UBS at a haircut of 2.5%. This was the first time CCC was obliged to accept a nominal haircut in excess of 2% [1305]. On 18th August 2007 Carlyle’s head in-house legal adviser recommended that legal advice should be sought about the potential bankruptcy of CCC [1315]. On 20th August 2007 CCC held meetings with its six underwriting banks in a concerted attempt to try to rally support from its bankers [1318]. At [1319], the Lieutenant Bailiff said this:-

“In the event, the results of the six meetings were mixed.... It appears that Citi and Lehman agreed to maintain 2% haircuts, although as Lehman were now setting their own marks, this rather negated the direct beneficial effect of this for CCC. Deutsche Bank was described as being “reasonably calm”. Bear Stearns indicated that their attitude would have to depend on the haircuts they were themselves being subjected to for the repo funding by which they provided their own funds. CCC had no repo lines outstanding with either JP Morgan or Goldman Sachs at the time, and Mr Conway apparently asked Goldman to consider providing CCC with a \$1 Bn line at a 2% haircut. It was the final meeting with JP Morgan which both Mr Stomber and Mr Conway recall most vividly, although partially. They say that this was because the attitude of Mr Steven Black gave them a shock”.

122. What Mr Black did was to recommend that CCC should immediately undertake the sale of \$10 Bn of its Agency RMBS. He also apparently said that CCC could expect to receive \$100 Mn of margin calls the following day [1320]. The Lieutenant Bailiff accepted that it would have been apparent that there would be no prospect of persuading JP Morgan to advance repo finance to CCC at a 2% haircut [1321]. CCC took the view that “an immediate sale of \$10 Bn of Agency RMBS was too draconian a step; it might cause the market, and in particular CCC’s bankers, to question CCC’s ongoing viability and it could have adverse consequence in triggering lower marks to market for the value of CCC’s remaining RMBS, with a consequent liability for margin calls which would reduce or wipe out the liquidity gain” [1324].
123. It was in those extreme circumstances that CCC took the decision to sell up to \$4 Bn of Agency RMBS to JP Morgan. We do not regard the episode as any indication that CCC accepted that selling RMBS was the only, or a desirable, thing to do as a general strategy.
124. At [2034] the Lieutenant Bailiff described the Downside Case in the following terms:-

“The “Downside Case” assumed a more pessimistic course, but this time involving the sale of a significant quantity (\$4Bn) of RMBS. The assumptions (apart from the obvious one that no dividends were to be paid at all) were that haircuts all moved immediately to 3%, and RMBS prices fell to the “lowest point of Q3” which thus came to represent supposed fair values. These latter assumptions implied a cash shortfall of approximately \$13.7 Mn in the fourth quarter of 2007, and it was posited that to meet this, there would be a sale of \$4 Bn of RMBS “at lowest mark of Q 3 to raise cash”, i.e. at repo marks only. Such a sale would, essentially, release the applicable 3% haircut, or

about \$120 Mn in cash, and assuming that repo dealers' distressed pricing of collateral simply continued as it had been and did not change (worsen or improve) CCC would still increase its cash liquidity on that basis."

125. The Lieutenant Bailiff's finding in relation to the Downside Case was that it was "*put forward as an illustration to indicate to PwC that CCC could, potentially, make such sales at the losses there indicated and still survive, by which I mean, remain solvent. It was a hypothetical case, and I do not find it to be evidence that Mr Stomber held a belief that such sales actually could have been made in general terms, at the particular time.*" [2230] In coming to that conclusion, the Lieutenant Bailiff cannot have thought that the Downside Case involved sales at anything other than repo prices: see her reference to "repo marks only" in [2034]. In our view, her finding about the purpose and import of the Downside Case is unassailable.
126. As mentioned at [72] above, there was one further piece of evidence relied upon by the Appellants in addition to the willingness of the directors to sell at repo marks in August 2007 and the significance of the Downside Case. This was the position of CCC's auditors, PwC, who were prepared to issue an opinion in November 2007 that CCC could be treated as a "going concern".
127. This relates to a tranche of evidence in respect of the work of PwC, as the auditors of CCC, when engaged on the third quarter financial audit of CCC in 2007. As found by the Lieutenant Bailiff at [1584], on 26th September the question of PwC's evaluation as to the ability of CCC to continue as a "going concern" was raised with CCC by PwC and their work was to include, among other matters, a sensitivity analysis with regard to future events such as possible changes in market prices and the impact on haircuts. The essence of the argument for the Appellants is that notes of meetings between CCC and PwC showed that there was agreement that the prices which could be achieved on a sale of RMBS at that time would not be distressed prices in that normality was returning to the markets. It was anticipated that sales would be above repo prices. When it came to PwC repricing the RMBS themselves there was little difference between their pricing and IDP pricing; and this showed – as did audit working papers – that pricing the portfolio at fair value in terms of US GAAP as at September 2007 did not require the use of valuations presented by repo counterparties.
128. For the Appellants it was emphasised that the Lieutenant Bailiff had concluded that PwC had not been misled by CCC and accepted the PwC evidence that their repricing was an independent valuation exercise: reference is made to [2205], [2217], [2211]-[2223]. As the Appellants contended, such a finding indicated that PwC, properly carrying out their obligations as auditors, considered that RMBS should be priced at IDP prices in CCC's accounts. In a nutshell, such a position was inconsistent with the findings of the Lieutenant Bailiff that, as at autumn 2007, CCC, or anyone else, would have had material concerns as to sale of RMBS because of the perceived risks of selling.
129. It is necessary, at this stage, to note that the exploration of this issue, as presented by the Appellants, required more detailed examination of certain aspects than was necessary for the Lieutenant Bailiff. This is because, at trial, the position for the present Appellants was, contrariwise, to question whether PwC had given an "independent" revaluation of CCC's RMBS assets at all. As the Lieutenant Bailiff expressed the matter at [879], the then Plaintiffs had argued that the fact that the valuations were within \$72 of each other was so extraordinary as to be incredible and, accordingly, the then Defendants could not reasonably have placed any reliance on the PwC valuation as proper confirmation. However the Lieutenant Bailiff was impressed with the evidence of Mr. Reville of PwC, the partner in PwC with overall responsibility for CCC's affairs. She found his evidence as to the conduct of the PwC reviews

to be lucid and helpful and, overall, that he had been a good witness on whose evidence she felt that she could safely rely: see [903] – [906].

130. Because of the present approach of the Appellants it therefore became necessary to consider an internal PwC document issued in late 2007 in response to the liquidity crisis which had emerged and with specific reference to "going concern" appraisals.
131. From a full consideration of that document it became clear to us, and was eventually accepted by Advocate Wessels for the Appellants, that, once those carrying out the appraisal for the purposes of the review had concluded that the assumption to be made was that there was an 'active market' with sales other than distressed sales, RMBS, pursuant to the relevant IFRS Accounting Standard, had to be included in the accounts at their IDP/FT value.
132. It therefore follows that the PwC "going concern" analysis does not assist in identifying whether the directors of CCC perceived there to be material risks in autumn 2007 in placing substantial quantities of RMBS for sale.
133. We conclude this section with two general points. First, one of the more compelling reasons for rejecting the Appellants' claim that the only possible course that a reasonable board of directors could have adopted was to sell RMBS is that the capital preservation strategy was for a time justified by events. Although the liquidity cushion fluctuated, the effect of returns of margin, amortisations and repayments was to go some way to restore it. Thus the liquidity cushion was at 19% at the end of October 2007 [1984] and at around 20% in early November 2007. By the end of November it had fallen to 10.5% [2087]; and it fell again to 9.7% on 11th December 2007 [2251], although it increased once more after the repo roll on 17th December 2007 [2253]. It was at 9.3% at the start of January 2008, at 16% on 10th January 2008, and it remained at or above that level until 20th February 2008 (reaching nearly 20% on 14th February 2008 [2341]), when it fell to 13.4%. It declined to 10.4% by the end of February 2008 [2303]. It had accordingly at times virtually attained what the Lieutenant Bailiff called the "magic" 20% mark [1986], that being the level set out in CCC's original business plan. The Lieutenant Bailiff rejected the suggestion that CCC was at that time aiming for a liquidity cushion of 40%. The suggestion was based on slides prepared for the Carlyle Investor Conference in September 2007, referred to at paragraph 34 above, which the Lieutenant Bailiff said were "nothing more than an illustration of what CCC might look like, or aspire to look like, in the future, as and when steps to shape a new business model in a more stable environment could be taken" [1556].
134. The second general point is that it was common ground that nothing that CCC could have done would have saved it from the consequences of the March 2008 liquidity crisis, which was unforeseen and unforeseeable. However startling the history of CCC's short life appears at first sight, its failure was the result of circumstances beyond the control of any board of directors. The Lieutenant Bailiff's view was that the Appellants' claim depended entirely on hindsight, and we agree with her.

(iv) *Conclusion on breach*

135. Cogent and impressive as the Appellants' submissions were, it is our judgment that, even if the Lieutenant Bailiff had not misunderstood the evidence as regards August 2007, a proper consideration of the August evidence even taken together with the application of greater weight to the evidence about the Downside Case is not a sufficient basis for this appellate court to interfere with her decision. As we have already remarked, the trial before the Lieutenant Bailiff was lengthy and complex by any standards and the judgment is detailed, careful and for by far the greater part unchallenged. For our own part, we have had the

advantage of detailed submissions in writing, two weeks of oral submissions and a comprehensive and accessible electronic database. These, together with the availability of time to consider the issues before us have enabled us to identify the principal competing considerations which arise as a result of the Appellants' submissions and our appreciation of their strength.

136. Most important, in our view, is the care which the learned Lieutenant Bailiff gave to her appraisal of each witness, both factual and expert, and her consideration as to the extent to which she could rely upon them. It seems to us that, in no small measure, her eventual finding that there had been no breach of duty was based upon her acceptance of the reliability of witnesses whose evidence, or portions of whose evidence, led to such a conclusion.
137. There is one particular section of the judgment in which the learned Lieutenant Bailiff expresses conclusions of considerable importance both generally and in respect of the issues which we have just addressed.
138. In respect of the position of the directors in September 2007, the learned Lieutenant Bailiff stated:

“General conclusions for September 2007

1885. The decision, as to whether to sell or continue to hold RMBS in September 2007 was a balancing exercise. It is, therefore one which is in principle a matter of business judgement, and one on which there may legitimately be differences of view. I am concerned here only with whether the decision made was outside the range of reasonable such business judgements and perhaps, if *prima facie* this is so, whether it was nonetheless conscientiously arrived at, in practical terms, according to the respective standards of care of the individual Defendants.

1886. In his witness statement Mr Stomber stated his views of the situation at the end of September to have been:

“Although a sale of some RMBS seemed more feasible in late September than it had appeared in mid- or late August, the secondary market still had not improved enough that a large player, such as CCC, could carry out sales of any meaningful volume without depressing prices or raising concern about its financial health. As a result, continuing to hold the portfolio while focusing our efforts on improving financing was, in my view, the most prudent course”.

1887. Mr Conway similarly says that his view was:

“It remained true, as it had been in August, that a sale of RMBS would involve a trade-off between, on the one hand, the potential benefit of some increased liquidity (and decreased leverage) and, on the other hand, the certainty of permanent losses, risk of downward pressure on prices and market perception of distress. In August, the Board’s judgment had been that the downside outweighed the upside, and as of the end of September, I thought that remained the correct judgment, although I realized that if circumstances changed (whether in the market or for CCC, or both), then the calculus might be different.”

1888. I am satisfied that these views were genuinely held by each of them, and I am satisfied that they were reasonably held. I am satisfied that the other members of the Board were of similar views, whether arrived at independently or because they received the views and advice of Mr Stomber and Mr Conway, or others, and because those views were judged to be convincing. This would have happened in all probability through such contact as they had with each other. Mr Allardice and Mr Hance were both generally involved in considering CCC's activities on a frequent basis and I have no doubt they considered the material points actively and properly. I am satisfied that these views were not only genuinely held, but were perfectly reasonable in all the circumstances, and certainly within the range of views that a reasonable director of CCC might properly and rationally hold at the time.

1889. I conclude therefore, that there was no breach of the Defendants' duties of skill and care to CCC with regard to the continuation of the capital preservation strategy in September 2007 or as at 30th September 2007, as alleged."

139. Given these views and the way in which they are expressed, and having regard to the detailed consideration of evidence which led to them, and the various matters we have discussed above we cannot say that an accurate understanding of the position in August 2007 taken together with greater weight being given to the "Downside case" of November 2007 would or should have led the learned Lieutenant Bailiff to the conclusion that the directors did not hold the view that large volume sales of RMBS in autumn 2007 carried serious risk, or that such a view was not reasonable in all the circumstances, or outwith the range of views that a reasonable director of CCC might properly and rationally have held at that time.
140. In summary, we consider that there was ample evidence to support the Lieutenant Bailiff's conclusion that there was no breach of duty.
- (v) *Breach of fiduciary duty by the Independent Directors*
141. In section D7 of their Written Case the Appellants submit that the Independent Directors were in breach of their fiduciary duty to CCC on 1st October 2007 by approving the suspension of the Investment Guidelines for three months and again on 13th November 2007 by approving the further suspension of those Guidelines until 31st March 2008. It is said by the Appellants that the Independent Directors should have required CCC to raise liquidity by selling RMBS. It is further said that they failed to exercise their own independent judgment and failed to inform themselves properly before reaching their decision.
142. Advocate Wessels did not elaborate on this point in his oral submissions and in our judgment, he was right not to do so. To the extent that the submission depends upon the reasonableness of not selling RMBS, the point fails for the reasons we have given in relation to the alleged breach of the duty of skill and care. To the extent that the submission goes beyond this Advocate Wessels faces an insuperable obstacle in the form of the Lieutenant Bailiff's findings of fact.
143. The Lieutenant Bailiff heard evidence from Mr Allardice over four days and each of Mr Sarles and Mr Loveridge over two days. She therefore had ample opportunity to assess their evidence. She concluded at [1638] – [1647] that the decision to suspend the Investment Guidelines on 1st October was both a proper decision and one which was properly made. She

also found at [2137] that the decision taken on 13th November was similarly not a breach of duty. She also specifically found at [2369]:-

“I also find that the material decisions and actions were taken and made by each individual Defendant in the bona fide belief that they were in the best interests of CCC, including, insofar as appropriate at any particular time, the material interests of CCC’s creditors.”

144. Given our decision in relation to the capital preservation strategy and the opportunity which she had of seeing the Independent Directors give evidence, there was ample material before her on which she could properly come to the conclusion the Independent Directors were not in breach of fiduciary duty as contended by the Appellants. We therefore uphold her decision.

(vi) *Ancillary issues*

145. Had we been inclined to favour the Appellants at this point in the appeal, it would have been necessary to address certain ancillary issues as to whether any breaches had caused the loss complained of and as to the quantification of any such loss. In argument on those matters we were treated to somewhat restricted development in oral presentation because of time constraints arising when other issues required greater exploration. In light of the views which we have reached, we do not consider it necessary to address these issues.

Consideration of the Defences

Possible Defences

146. In the light of our decision that the Respondents were not in breach of any of the duties which they owed to CCC, the remaining defences raised by the Respondents do not arise for decision. However, they were argued and resolution of some of them may be of assistance on future occasions. We shall therefore deal with a number of the points raised, albeit rather more briefly than might otherwise have been the case.

147. Unless otherwise stated, these possible defences relate only to the First to Seventh Respondents. To avoid confusion we shall refer to those Respondents as “the Directors” in this section of the judgment.

(i) *Incorporation of article 172*

148. The first possible defence arises from the terms of article 172 of the Articles of Association of CCC which, so far as material, reads as follows:-

“The Directors, Managing Directors, managers, agents ... for the time being of the Company ... shall be fully indemnified out of the assets and profits of the Company from and against all ... liabilities which they may ... incur by reason of any ... act in and about the execution of their respective offices ... except such (if any) as they shall incur by or through their own wilful act, neglect or default ... and none of them shall be answerable for ... any loss, misfortune or damage ... which may happen in or about the execution of their respective offices ... except the same shall happen by or through their own wilful act, neglect or default.” [emphasis added]

149. The Directors argue that the provisions of article 172 were incorporated into the terms upon which they held office as directors with the consequence that, even if they were in breach of their

duty of skill and care or fiduciary duty, they would not be liable unless the same amounted to ‘wilful default’ or ‘wilful neglect’. We see no difference between these two expressions and, in order to avoid unnecessary repetition, will hereafter, unless necessary, refer simply to ‘wilful default’ to cover both concepts. The Appellants, on the other hand, submit that article 172 was not incorporated in the Directors’ terms of engagement with the consequence that, if the Directors are found to be in breach of their duty to exercise reasonable skill and care or fiduciary duty, they are liable and obtain no protection from article 172.

150. It is not disputed that the articles of a company constitute a contract between the members of the company inter se and between each of them and the company; but they do not as such constitute a contract between the company and its directors. However, there have been a number of cases which have considered whether the terms of a provision such as article 172 have been incorporated into the terms upon which a director holds office, including a recent decision of this Court.

151. In In re New British Iron Co. Ex p Beckwith [1898] 1 Ch. 324, the directors of a company claimed in respect of unpaid remuneration by virtue of an article which provided that each director should be paid an annual sum of £1,000. Wright J held that the directors were so entitled and said at 326:-

“That article is not in itself a contract between the company and the directors; it is only a part of the contract constituted by the Articles of Association between the members of the company inter se. But where on the footing of that Article the directors are employed by the company and accept office, the terms of Article 62 are embodied in and form part of the contract between the company and the directors.”

152. To like effect was the decision in In re Anglo-Austrian Printing and Publishing Union, Isaacs’ case [1892] 2 Ch. 158 where at 164-165 Stirling J said:-

“I think, then, that where a man has accepted the office of director, and acted as such, there ought to be inferred an agreement between him and the company, on his part that he will serve the company on the terms as to qualification and otherwise contained in the articles of association, and on the part of the company that he shall receive the remuneration, and all the benefits which those articles provide for directors.”

153. His decision was upheld by the Court of Appeal. Bowen LJ said this at 167-168:-

“What is the effect of the signature of the articles of association by this gentleman? At all events, as soon as he acts as a director of the company, and places himself in the position for which the articles provide, these articles shew the terms of the implied contract which thereupon arises between himself and the company. That is the effect of these articles – they amount to an offer put forward by the company to persons intending to become directors of the terms on which the directors are to act. It is perfectly true that the offer is contained in articles, which are not drawn up as between the company and its directors, but nevertheless the company puts forward the terms of the articles as the terms by which it would be bound; and the director by becoming and acting as director of the company accepts that position.”

154. Lindley and Kay, LJJ (at 166 and 169 respectively), while also adverting to the signature, agreed that the very fact of acting as a director established that a person was bound by the articles of association.

155. Advocate Dawes, who presented the argument on this aspect of the case on behalf of the Appellants, placed reliance on the decision of Ferris J in John -v- PricewaterhouseCoopers [2002]

1 WLR 953. Having said at [26] that articles do not ‘*without more*’ constitute a contract between the company and its directors or auditors, Ferris J went on to say in the same paragraph:-

“Nevertheless the terms of Regulations 136 and 118 appear clearly to contemplate that directors and auditors (amongst others) will have a right, which could only be a contractual right, to be indemnified as they are mentioned. It seems to me that comparatively little will be required to satisfy the court that, in particular cases, the indemnity provided for by Regulations 136 and 118 is incorporated in the contract which is made when the company appoints a director or an auditor.”

156. Ferris J went on to quote from the judgment of Warrington LJ in In re City Equitable Fire Insurance Co. Limited [1925] Ch. 407 which was concerned with whether auditors could take advantage of a provision indemnifying them in the articles. Warrington LJ said at 520-521:-

“In the first place, I think that that article, as the judge has held expressly in the case of directors and impliedly, if not expressly, in the case of auditors, does in such a case as the present form part of the contract between the company and the auditors, and for the reason that auditors are engaged without any special terms of engagement. When that is the case, then if the articles contained provisions relating to the performance by them of their duties and to the obligations imposed upon them by the acceptance of the office, I think it is quite plain that the articles must be taken to express the terms upon which the auditors accept their position. Of course, if the terms of their employment are expressed in a separate document, then that document must be taken to define the conditions of their engagement, and it would not be proper to assume any implied terms either from the provisions of the articles or elsewhere.”

157. All the above cases except City Equitable Fire Insurance were considered by this Court in Perpetual Media Capital Limited –v- Enevoldsen [2014] GLR 57. Having done so, Beloff JA, in a judgment agreed by the other members of the Court, said this at [35]:-

“Insofar as there is any discrepancy between the approach in the cases of John and Isaacs, I prefer that Guernsey law should reflect the latter. In short, there is a presumption, albeit rebuttable, that directors take up office on the terms in the company’s articles....”

158. Advocate Dawes submitted that Perpetual Media was wrongly decided. First, it ignored the implication in John that there has to be some evidence that the terms of the relevant article have been incorporated in the agreement between the director and the company even if ‘*comparatively little*’ is required in the way of evidence. Secondly, the Court was wrong to introduce the concept of a ‘presumption’. This was inconsistent with the previous authorities.

159. We would only depart from a previous decision of this Court if satisfied that it was plainly wrong. Far from that being the case, we agree with the decision and see no objection to the use of the word ‘presumption’ in the context in which it was used. However, if objection is taken to the use of the word ‘presumption’, an alternative way of saying it might be to refer to a ‘starting point’. Thus, where a person accepts appointment as a director, the starting point will be that he does so upon the terms set out in the articles. That position is, in our judgment, entirely consistent with the statement in Isaacs’ case to the effect that what is contained in the articles reflects the terms upon which the company offers to employ a person as a director and the person accepts those terms by becoming and acting as a director. To the extent that John says anything different (and we are not sure that in reality it does) we agree that Isaacs’ case is to be preferred.

160. However, the starting point will not necessarily be the finishing point. That will turn on whether there is evidence to suggest that the relevant article has not been incorporated in the terms upon which a person acts as a director. An example would be where the director has a specific employment contract with the company. As stated by Warrington LJ in the passage quoted above, where that is the case the terms of the employment contract will take precedence over the articles. We would add that, if there is no inconsistency between the employment contract and the relevant article, the article may well still be treated as being incorporated in the terms of engagement, but that will depend upon the particular circumstances.
161. Turning to the facts of this case, the Lieutenant Bailiff held (correctly) that she would follow Perpetual Media. She went on to say at [707] that the threshold for establishing that the articles were not impliedly incorporated into any director's service arrangements will be high for the purposes of rebutting the presumption. We think the judge fell into error in putting it this way. It is simply a question of looking at all the evidence and deciding whether the 'starting point' or 'presumption' referred to above reflects the position or whether the evidence shows that the relevant article has not been incorporated in the terms of engagement.
162. The Lieutenant Bailiff did not consider whether article 172 was in fact incorporated in the terms of engagement of the Directors because she dismissed the Appellants' claims in any event. Counsel have agreed that we should conduct that exercise for ourselves and we have been referred to the material which each side considers relevant.
163. Advocate Dawes concentrated on the position in relation to Mr Stomber. He accepted that if he was unsuccessful in his submission that article 172 was not incorporated in Mr Stomber's appointment, he would also be unsuccessful in relation to all the other Directors.
164. The only written agreement between CCC and Mr Stomber is a one sentence letter dated 14th September 2006 from Mr Stomber to CCC in which he says "*I hereby confirm my acceptance to act as a Director of the Company with immediate effect*". Advocate Dawes noted that there was no reference in that letter to the articles of association. He went on to submit that, although minutes of a meeting of the Board of CCC on 4th October 2006 (at which Mr Stomber was present) referred to copies of the articles of association having been provided to the Board, the copies of the pack supplied to the Board which were made available during the course of these proceedings did not appear to include the articles of association. There was therefore no direct evidence that Mr Stomber had seen the articles. In evidence, Mr Stomber said that he could not recall whether he had read the articles.
165. In our judgment, none of these points comes anywhere near sufficient to depart from the starting point referred to earlier. It is not necessary to show that a director has read the articles or the particular article which is said to be incorporated or that the article is specifically referred to in any engagement letter. It is the acceptance of the office of director which, in the absence of anything to the contrary, indicates acceptance of the terms (both benefits and burdens) for directors set out in the articles.
166. Advocate Dawes placed considerable reliance upon the employment contract entered into between Mr Stomber and one of the companies within the Carlyle Group. This contract specifically set out that Mr Stomber would be employed by the Carlyle company and remunerated by that company, but would be serving as President and Chief Executive Officer of CIM and as President and Chief Executive Officer of CCC upon election by the Board of CCC. The agreement specifically states that nothing in the agreement is intended to create an employment relationship between Mr Stomber and CCC, nor will he be remunerated by CCC. Advocate Dawes placed particular reliance upon the fact that the employment contract with the Carlyle company contained various indemnity provisions (whereby Carlyle indemnified Mr Stomber) which were not in the same terms as article 172. It also contained provisions for

insurance of liability as a director. However, it seems to us that a contract between Carlyle and Mr Stomber cannot be relevant in determining whether or not the terms of article 172 have been incorporated in the relationship between CCC and Mr Stomber. CCC was not party to the employment contract between Mr Stomber and Carlyle. The relationship between CCC and its director cannot be determined or affected by an agreement between another entity and that director to which CCC was not a party.

167. In our judgment, there is nothing in the material produced to us to suggest that the starting point referred to above should be departed from and accordingly we hold that article 172 was incorporated in the relationship between Mr Stomber and CCC. As already stated, Advocate Dawes accepts that if article 172 was incorporated in the case of Mr Stomber, it is also to be regarded as incorporated in the case of all the other Directors.
168. Although the submissions of the parties concentrated on article 172, our conclusion is the same in respect of article 174(2), which is referred to below. For the same reasons, it too was incorporated in the terms of service of the Directors.

(ii) Wilful default

169. It follows that, if the Court had found the Directors to be in breach of duty, it would have been necessary to decide whether such breaches amounted to wilful default. Whilst both parties agree that the classic formulation of what is meant by wilful default is to be found in the judgment of Romer J in Re City Equitable Fire Insurance Co. Limited [1925] Ch. 407, they do not agree on its effect.
170. City Equitable was a case where the articles of association provided that directors would only be liable for their own ‘wilful neglect or default’. In an action brought by the liquidator against the directors, Romer J sought to establish what was meant by this phrase. At 434 he said:-

“If I may say so with respect, the difficulty is not so much in ascertaining the meaning of the adjective ‘wilful’ as in ascertaining precisely what is the noun to which the adjective is to be applied. An act, or an omission to do an act, is wilful where the person of whom we are speaking knows what he is doing and intends to do what he is doing. But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing, and intends to commit, a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty.”

His formulation was approved by all three judges in the Court of Appeal.

171. As can be seen, the formulation has two limbs. A person is guilty of wilful neglect or default if he (i) knows he is committing a breach of duty or (ii) is recklessly careless as to whether his conduct is a breach of duty or not. The first limb is self-explanatory and it has not been suggested that it is applicable in the present case. As to the second limb, the parties are not agreed on what is meant by being ‘recklessly careless’. Advocate Dawes submits that it is sufficient if a person has knowledge of facts and circumstances which would indicate to a reasonable person that his conduct might be a breach of duty and the person then consciously proceeds with the conduct regardless. It is not necessary to show that the person subjectively appreciated that his conduct might be a breach of duty. Advocate Swan, on the other hand, submits that a person is only recklessly careless if he appreciates that his proposed conduct might be a breach of duty and decides to proceed nevertheless.

172. In our judgment, Advocate Swan is correct. In his judgment, Romer J referred to a number of previous cases where a similar issue had arisen. He referred in particular to Lewis –v- Great Western Railway Co. (1877) 3 QBD 195. The issue in that case was whether damage to the plaintiff’s cheese had been caused by the ‘wilful misconduct’ of the defendant’s servants. At 206 Bramwell LJ said this:-

““Wilful misconduct” means misconduct to which the will is a party, something opposed to accident or negligence; the misconduct [original emphasis], not the conduct, must be wilful. It has been said, and, I think, correctly, that, perhaps, one condition of “wilful misconduct” must be that the person guilty of it should know that mischief will result from it. But to my mind there might be other “wilful misconduct”. I think it would be wilful misconduct if a person did an act not knowing whether mischief would or would not result from it. I do not mean when in a state of ignorance, but after being told, “now this may or may not be a right thing to do.” He might say, “well, I do not know which is right, and I do not care; I will do so this.” I am much inclined to think that that would be “wilful misconduct”, because he acted under the supposition that it might be mischievous, and with an indifference to his duty to ascertain whether it was mischievous or not. I think that would be wilful misconduct.” [emphasis added]

173. To like effect was the judgment of Cotton LJ at 213 where he said:-

“Now, I do not think there can be any doubt at all that wilful misconduct is something entirely different from negligence, and far beyond it, whether the negligence be culpable, or gross, or howsoever denominated. There must be the doing of something which the person doing it knows will cause risk or injury, or the doing of an unusual thing with reference to the matter in hand, either in spite of warning or without care, regardless whether it will or will not cause injury to the goods carried or other subject-matter of the transaction.”

174. Advocate Dawes suggested that the passage in the judgment of Cotton LJ which immediately follows the above quotation – which passage gives, as an example of wilful misconduct, leading a horse into an open truck out of which he could jump because everyone would be aware that, as soon as the train started the horse would try to jump out and be seriously injured – indicates that it is not necessary for the person to have appreciated the risk; it is sufficient if everyone would have been aware of the risk. We agree that the passage is somewhat ambiguous but it is hard to reconcile the example given with the clear statement that wilful misconduct is something entirely different from negligence, even gross negligence. A failure to appreciate the risk of a horse jumping out (even though everyone else would) would seem to be a classic example of straightforward negligence (whether gross or not).

175. In Spread Trustee Company Limited –v- Hutcheson [2012] 2 AC 194 the Privy Council emphasised the distinction between gross negligence and wilful misconduct. Thus at [51] Lord Clarke, speaking for the majority, said *“To describe negligence as gross does not change its nature so as to make it fraudulent or wilful misconduct.”* To like effect was Lord Kerr, one of the dissenting judges, at [61] where he accepted the *‘conceptual dividing line between fraud or dishonesty (or wilful misconduct) on the one hand and negligence, even gross negligence on the other’*. Lord Clarke went on at [55] to quote with approval the passage emphasised above from the judgment of Bramwell LJ in Lewis.

176. The importance of attributing weight to the word ‘wilful’ in the expression ‘wilful wrongdoing’ was again emphasised in the decision of the English Court of Appeal in Barnsley -v- Noble [2016] EWCA Civ. 799. The case was concerned with the interpretation of an exoneration clause in a will trust which exempted the trustees from any liability *‘except wilful and individual fraud or wrongdoing on the part of the trustee who is sought to be made liable...’*.

177. Etherton C said at [60] that, in the context of an exoneration clause, there was no difference in the meaning of the expressions ‘wilful default’, ‘wilful misconduct’ and ‘wilful wrongdoing’.
178. It was argued on behalf of the beneficiary in that case that the word ‘wilful’ bears the very wide meaning of ‘intentional’, in the sense that a person acts intentionally if he intends to do a specific act or consciously makes a specific omission and that act or omission happens to constitute wrongdoing, whether or not the person knew his act or omission was wrongful and whether or not he intended to behave in breach of his legal obligations.
179. This was roundly rejected by the Court of Appeal. In passing at [39], Sales LJ endorsed the emphasised observation of Bramwell LJ in Lewis referred to above and went on to say “*The same point applies in respect of the phrase ‘wilful wrongdoing’: it is the wrongdoing not the doing, which must be wilful*”. [original emphasis]
180. The question of what is meant by ‘reckless carelessness’ was considered at length by the Court of Appeal of the Cayman Islands in Weaving Macro Fixed Income Fund Limited (in liquidation) - v- Peterson (CICA 10 of 2011). The issue in that case was whether the directors should be liable for certain actions and the relevant article was in similar terms to article 172 in that it exempted the directors from any liability unless it arose through the ‘*wilful neglect or default*’ of the director in question.
181. The Court adopted the formulation by Romer J and went on to carry out a thorough analysis of the relevant cases, including those we have referred to above but also a number of others. Having held that the directors’ actions did not amount to wilful default under the first limb of Romer J’s formulation, Sir John Chadwick P went on to consider whether they fell within the second limb of the City Equitable test as being ‘*recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty*’. Having considered the position at [110] – [116] (including a careful analysis of the the judgments of the Court of Appeal in both Lewis and City Equitable), he concluded at [117] as follows:-

“117. It follows that, in my judgment, the Directors are correct to contend that, in order to establish the liability of a director under the second limb of the City Equitable test – “recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty” – it is necessary to satisfy the court that the director appreciated (at least) that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences; and that if the evidence does not establish that the defendant at least suspected that his conduct might constitute a breach of duty, it is not appropriate to characterise his breach of duty as “wilful neglect or default” whether under the first or the second limb of the City Equitable test. To hold otherwise would, in my view, be to fail to give full meaning to the requirement that the “neglect or default” relied upon must be “wilful”.”

182. Advocate Dawes submitted that Weaving was wrongly decided. We disagree. In our judgment, the reasoning is compelling and it is consistent with earlier authority and with the clear statement of the Privy Council in Spread (and the other cases we have referred to) that wilful default (or misconduct or wrongdoing) differs from negligence, however gross.
183. If it is not necessary for the person concerned subjectively to appreciate that the proposed act or omission might amount to a breach of duty, we see no difference between being ‘recklessly careless’ and being negligent. In the latter case, the law considers the matter entirely objectively and simply considers what the reasonable person ought to have appreciated or ought to have done or omitted to do. Advocate Dawes’ formulation set out at para [171] above is apt to describe a negligent act or omission but gives no proper weight to the need for any default to be ‘wilful’.

184. Advocate Dawes also submitted that, in view of the fact that dishonesty is judged objectively (see Ivey –v- Genting Casinos (UK) Limited [2017] 3 WLR 1212) it was illogical to require a subjective appreciation of the risk of breach of duty when assessing the existence of wilful default, which is a less serious state of mind than dishonesty. This point was also raised in Barnsley but rejected by the Court of Appeal. We agree that no useful assistance can be derived from the concept of dishonesty when considering whether default is ‘wilful’ for the purposes of assessing wilful default.
185. In summary, we agree therefore that, in order for a person to be guilty of wilful default (or misconduct or wrongdoing) under the second limb of the formulation in City Equitable, it is necessary for the person concerned to have suspected (another way of saying ‘appreciated’) that his conduct might constitute a breach of duty but to have decided to continue with the conduct nevertheless.
186. Turning to the facts of this case, we have already held that the actions of the Directors in pursuing the capital preservation strategy did not amount to a breach of duty. If we are wrong in that finding, we would nevertheless hold that the Directors have not been guilty of wilful default. There is no evidence from which a court could properly infer that any of the Directors suspected that pursuing the capital preservation strategy might constitute a breach of duty.

(iii) Sections 106 and 67F of the Companies (Guernsey) Law 1994 (“the 1994 Law”)

187. On the basis of the Court’s finding that the terms of article 172 were incorporated in the Directors’ terms of service, the question then arises as to whether the effect of section 67F of the 1994 Law (when read with section 106 of the same Law) is to prevent the Directors from relying on the protections conferred by article 172 in relation to the claims by the liquidators. It seems to us that this in turn gives rise to the following two issues for consideration:-
- (i) Do the breaches of the duty of skill and care alleged by the Plaintiffs amount to ‘misfeasance’ within the meaning of section 106?
 - (ii) If so, does section 67F prevent the Directors from relying upon the protections conferred by article 172?

188. Section 106 is in the following terms:-

“Remedy Against Delinquent Officers

106(1) Where in the course of the winding up of a company it appears that any person described in sub-section (2):

- (a) has appropriated or otherwise misapplied any of the of the company’s assets;***
- (b) has become personally liable for any of the company’s debts or liabilities; or***
- (c) has otherwise been guilty of any misfeasance or breach of fiduciary duty in relation to the company;***

the liquidator or any creditor or member of the company may apply to the Court for an order under this section.

(2) The persons mentioned in sub-section (1) are:-

- (a) any past or present officer of the company;***
- (b) any other person who, directly or indirectly, is or has been in any way concerned in or has participated in the promotion, formation or management of the company.***

(3) On an application under sub-section (1) the Court may examine the conduct of the person concerned and may order him:-

- (a) to repay, restore or account for such money or such property;**
- (b) to contribute such sum to the company's assets;**
- (c) to pay interest upon such amount, at such rate or from such date,**
as the Court thinks fit in respect of the default, whether by way of indemnity or compensation or otherwise."

189. Section 67F provides, so far as material, as follows:-

"Company Articles, etc., may not exclude remedies

67F(1) Any provision, term or condition, in whatever words, and whether contained in a company's articles or in any contract with the company or otherwise, for exempting any person from, or indemnifying him against, any liability which, pursuant to sections 67A to 67D or any other provision of this Law under which personal liability may be imposed or incurred, would otherwise attach to him shall, subject to sub sections (2) and (3), be void." (Emphasis added.)

190. As can be seen therefore, it is important to ascertain whether any liability of the Directors is 'imposed or incurred' pursuant to Section 106, being the only relevant 'provision of this Law'. If liability for the alleged breaches of duty are 'imposed or incurred' under Section 106, then the exoneration and indemnification provisions contained in article 172 will be void and of no effect by reason of Section 67F.

191. Section 106 is based on (although not identical to) a long standing corresponding provision of the English legislation in connection with companies. Thus section 165 of the Companies Act 1862 provided as follows:-

"Where, in the course of the winding up of any company under this Act, it appears that any past or present director, manager, official or other liquidator, or any officer of such company, has misapplied or retained in his own hands or become liable or accountable for any monies of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may, on the application of any liquidator, or of any creditor or contributory of the company, ... examine into the conduct of such director, manager or other officer, and compel him to repay any monies so misapplied or retained, or for which he has become liable or accountable, together with interest after such rate as the court thinks just, or to contribute such sums of money to the assets of the company by way of compensation in respect of such misapplication, retainer, misfeasance, or breach of trust, as the court thinks just." [Emphasis added]

192. This provision has been re-enacted on numerous occasions in essentially the same terms including section 10 of the Companies (Winding Up) Act 1890, section 276 of the Companies Act 1929, section 333 of the Companies Act 1948, and section 631 of the Companies Act 1985. No material change in the terms of the provision was introduced until section 212 of the Insolvency Act 1986, to which we refer below.

(a) Misfeasance

193. With that introduction, we turn to consider the two issues mentioned above in [187] and begin with the question whether the alleged breaches of the duty of skill and care constitute

misfeasance for the purposes of Section 106. If they do not, that section has no application to the breaches, with the consequence that Section 67F will not be relevant.

194. The Lieutenant Bailiff discussed this issue at [633] – [645] and concluded at [643] that Section 106(1)(c) is limited to “(a) *misdeeds resulting in improper application or improper diversion of the company’s property, or (b) breaches of fiduciary duty.*” It did not extend to a right to recover damages for simple breach of the duty of skill and care i.e. mere negligence.
195. Advocate Dawes submits that she erred and that ‘misfeasance’ in Section 106(1)(c) includes negligence in the performance of a director’s duties, i.e. any breach of the duty of skill and care.
196. We were not referred to any previous decision of the Guernsey courts on the point. As the Lieutenant Bailiff correctly held at [350], where a Guernsey statute is modelled on English legislation, it is permissible and indeed often helpful to look at English decisions on the interpretation of the equivalent English legislation. Such decisions are of course not binding and the Guernsey courts are free not to follow them, but they may often be persuasive.
197. The various English equivalents of Section 106 have been the subject of judicial decision in England and in our judgement, contrary to the submission of Advocate Dawes, those cases support the Lieutenant Bailiff’s decision that ‘misfeasance’ in this context does not extend to mere negligence in the performance of a director’s duties.
198. The first point which emerges clearly from the English authorities is that the English provision was introduced simply in order to provide a quicker and simpler means of proceeding in the context of a winding up. The provision was merely procedural and did not introduce any new cause of action, merely an alternative method of litigating an existing cause of action – see for example, In Re B Johnson & Co (Builders) Limited [1955] Ch. 634 at 647 per Evershed MR.
199. The meaning of ‘misfeasance’ in section 10 of the Companies (Winding Up) Act 1890 was considered in the case of In Re Kingston Cotton Mill Company (No. 2) [1896] 2 Ch. 279. In that case one of the directors of the company had supplied the auditors with grossly overstated valuations of the stock in trade. As a result, dividends had been paid in circumstances where, if the stock in trade had been stated at its true value, it would have been apparent that there were no profits out of which a dividend could be declared. The Court of Appeal held that the auditors had not on the facts been in breach of their duty to the company. However, in coming to its decision, the court considered the meaning of ‘misfeasance’ in the relevant section. Lindley LJ said at 283:-

“It has already been decided that the auditors of this company are “officers” within the meaning of s.10 of the Companies (Winding Up) Act 1890. The object of that section is the same as that of s.165 of the Companies Act 1862, which it has replaced. That object was to facilitate the recovery by the liquidator of assets of a company improperly dealt with by its promoters, directors, or other officers. The section applies to breaches of trust and to misfeasances by such persons. I agree that the section does not apply to all cases in which actions will lie by the company for the recovery of damages against the persons named; it is easy to imagine cases of breach of contract, trespasses, negligences, or other wrongs to which the section is inapplicable, and some such have been the subject of judicial decisions; but I am not aware of any authority to the effect that the section does not apply to the case of an officer who has committed a breach of his duty to the company, the direct consequence of which has been a misapplication of its assets, for which he could be made responsible by an action at law or in equity. Such a breach of duty, if established, is a “misfeasance” within the meaning of the section...”

200. Lopes LJ described the position as follows at 288:-

“It has been held that an auditor of a company is an officer within the meaning of the section... but has there been any misfeasance by the auditors? This depends upon what meaning is to be assigned to the word “misfeasance” as used in this section. The learned judge in the Court below held that misfeasance covered any misconduct by an officer of the company as such for which such officer might have been sued apart from the section. In my judgment this is too wide. It would cover any act of negligence – any actionable wrong by an officer of a company which did not involve any misapplication of the assets of the company. The object of this section of the Act is to enable the liquidator to recover any assets of the company improperly dealt with by any officer of the company and must be interpreted bearing that object in view. It doubtless covers any breach of duty by an officer of the company in his capacity of officer resulting in any improper misapplication of the assets or property of the company.”

201. This restricted view of the meaning of ‘misfeasance’ seems to have become well established. In Johnson Builders (cited above) Evershed MR summarised the position (in relation to what was by then section 333 of the 1948 Act) as follows at 648:-

“... it will be perhaps desirable that I should say something also on the second point, namely, whether the allegations made against the receiver were allegations of “misfeasance”, as that word is understood in the section. That point raises the problem of the scope of section 333, not as regards the persons who are subject to the procedure ordained by that section, but as regards to the nature of the claims which may be made under it. I repeat, that the section is a procedural section. There is no such distinct wrongful act known to the law as “misfeasance”. The acts which are covered by the section are acts which are wrongful, according to the established rules of law or equity, done by the person charged in his capacity as “promoter, director,” etc. But it is clearly established that it is not every kind of wrongful act so done that is comprehended by the section. At one end of the scale it may, I think, be taken as prima facie clear that a wrongful act involving misapplication of property in the hands of the person charged would be covered by its terms. At the other end of the scale, a claim based exclusively on common law negligence, an ordinary claim for damages for negligence simply, would not be covered by the section. Nor is such a claim brought within the section by the mere expedient of adding epithets to the negligence charged, calling it “gross” or “deliberate”. Nor, by that expedient, without more, can what in truth is merely negligence be converted into something else, namely, breach of trust. But in between the two extremes that I have mentioned, there is obviously a large range of conduct which may (or may not) be within the section. I shall follow others in not attempting any precise definition of what does or does not fall within it.”

202. Support for the proposition that misfeasance was understood not to include mere negligence in the performance of an officer’s duties is gained from the fact that the wording of the English provision – which had remained essentially unaltered since the 1862 Act – was amended in section 212 of the Insolvency Act 1986, sub-section (1) of which provided as follows:-

“(1) This section applies if in the course of the winding up of a company it appears that a person who-

- (a) is or has been an officer of the company,*
- (b) has acted as liquidator ... or administrative receiver of the company, or*
- (c) not being a person falling within paragraph (a) or (b), is or has been concerned, or has taken part, in the promotion, formation or management of the company,*

has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company. [Emphasis added]

The key change was to substitute breach of fiduciary duty for breach of trust and to extend the provision to include breach of any ‘*other duty*’.

203. Further support for the view that misfeasance did not include a mere breach of the duty of skill and care can be obtained from the observations of two judges since the introduction of section 212 of the Insolvency Act 1986.

- (i) In Re D’Jan of London Limited [1993] BCC 646, Hoffmann LJ, sitting as a judge of the Chancery Division, said as follows at 647:-

“This is a summons under sec.212 of the Insolvency Act 1986 by a liquidator against a former officer of the company. This is a summary procedure which used to be called a misfeasance summons but has been extended to include breaches of any duty including the duty of care.”

- (ii) Cohen –v- Selby [2001] 1 BCLC 176 also involved an application under section 212 of the 1986 Act. In the Court of Appeal, Chadwick LJ said this at [20]:-

“... Section 212 is the successor to s 333 of the Companies Act 1948. It, and its statutory predecessors, have been in the Companies Acts since 1862. It provides a summary procedure in a liquidation for obtaining a remedy against delinquent directors without the need for an action in the name of the company. It does not, of itself, create new rights and obligations. The scope of the section was enlarged by the 1986 Act (or, more accurately, by the Insolvency Act 1985, in which s212 was enacted as s19) to include ‘breach of other duty’; thereby removing the limitation imposed by the concept of misfeasance which had been identified by Evershed MR in Re B Johnson & Co (Builders) Limited There can be no doubt, now, that a liquidator can proceed under s212 of the Insolvency Act 1986 where all that is alleged is common law negligence....”

204. Advocate Dawes makes two points in relation to these two cases. First, he submits that the reference by Chadwick LJ to there now being ‘*no doubt*’ suggests that the position had been doubtful before the introduction of section 212. We do not read the observation of Chadwick LJ in that manner. His previous sentence states unambiguously that the concept of misfeasance had previously been limited as identified by Evershed MR in Johnson Builders i.e. it did not include cases where all that was alleged was mere negligence. Secondly, he submits that these are simply obiter observations on which, no doubt, there had not been any argument. We agree that they were obiter observations but they were made by two highly experienced and respected Chancery judges and are entirely consistent with the decisions in Kingston Cotton Mill and Johnson Builders.

205. Advocate Dawes referred us to two cases which he said pointed in the opposite direction. The first was Re Continental Assurance Co. of London Plc (In Liquidation) (No. 4) [2007] 2 BCLC 287. That was a case where the liquidators brought an action against the directors for wrongful trading under section 214 of the Insolvency Act 1986 and misfeasance under section 212. All the claims were dismissed, but Advocate Dawes relied on the following observation of Park J at [393]:-

“Misfeasance is the customary expression for breach by directors of duties owed to the company, one of which is their common law duty to exercise an appropriate level of care and skill in the performance of their functions. Therefore a misfeasance claim may be a claim at common law....”

He submits that Park J clearly envisaged misfeasance as including a simple breach of the duty of skill and care. However, it has to be borne in mind that this case occurred after the amendment introduced by section 212 in 1986. It was clear that a misfeasance summons (as it was still apparently customarily called) could by then include a simple breach of the duty of skill and care. The question of whether, prior to 1986, misfeasance had included such a breach simply did not arise and it is noteworthy that none of the cases to which we have referred (apart from Cohen -v- Selby in a different context) were cited to Park J in that case. Accordingly, we do not derive any assistance from the above extract.

206. Advocate Dawes also relied on an observation of Lopes LJ in In Re London and General Bank [1895] 2 Ch. 166. The issue in that case was whether the auditors of the company were ‘officers’ of that company for the purposes of section 10 of the 1890 Act. The Court of Appeal held that they were. In coming to this conclusion, it referred to the fact that section 10 referred to ‘misfeasance’. At 171, Lopes LJ said:-

“Now, if it were not for the word “misfeasance” in s10, I should not have thought that an auditor such as the auditor in the present case came within the meaning of that section. I should have thought that the section, if that word had been absent, was rather directed against those who had to carry out the business and purposes of the company, who had the control over the assets of the company, who had the conduct of the business, and who might have the money or the property of the company in their hands, which they might apply, retain or restore. But I find the word “misfeasance”, and as I understand the word “misfeasance” in this section it means a breach of duty. Now, if it means a breach of duty, one can quite understand a breach of duty which might be committed by an auditor.”
[Emphasis added]

207. Advocate Dawes emphasised the underlined passage and submitted that misfeasance therefore includes any breach of the duty of skill and care. However, one has to have regard to the passage immediately following that quoted above, where Lopes LJ goes on to say:-

“For instance, he might, in collusion with his directors, prepare a false account which would involve a misapplication of the assets. In such a case it seems to me that that would be one of the mischiefs which this section was intended to prevent.”

Similarly, in the course of his judgment Lindley LJ gave the following as an example of misfeasance:-

“... suppose that an auditor whose business it is to audit accounts and sign its balance-sheets knows perfectly well that the balance-sheet so signed by him will be acted upon, and that if it shews profits properly divisible as dividend, a dividend will be declared, and suppose that he purposely and fraudulently prepares and signs a balance-sheet shewing profits divisible when there are none – it appears to me that that is a distinct misfeasance within the meaning of the Act, leading to, and intended to lead, to a misapplication of the assets. Such a misfeasance, I have not the slightest doubt, would be a misfeasance within the meaning of the section.”

208. Bearing in mind these examples, together with the fact that the same judges decided Kingston Cotton Mill only a year later (in which they specifically referred to London and General Bank), we do not think that the underlined observation of Lopes LJ can bear the weight which Advocate

Dawes seeks to place on it. In context, the case is entirely consistent with Kingston Cotton Mill and with the position as described by Evershed MR in Johnson Builders.

209. In summary, we find that the position at English law was well established, in that the word ‘misfeasance’ in the statutory provision upon which Section 106 is based does not extend to mere negligence i.e. breach of the duty of skill and care.
210. Advocate Dawes submitted that, if we were against him on the English case law, we should not follow the English approach. He referred first to the fact that sub-section (1)(a) deals specifically with misapplication of the company’s assets. If misfeasance only applies in cases of misapplication of assets, it adds nothing to sub-section (1)(a). That clearly could not be right.
211. We agree that ‘misfeasance’ in sub-section (1)(c) must extend beyond matters which fall within sub-section (1)(a). However, the examples given by Lindley and Lopes LJJ in Re In London and General Bank are cases which would not fall within sub-section (1)(a) (because the auditors have not themselves appropriated or misapplied company assets) but would constitute misfeasance as they involve the misapplication of assets, albeit by others as a result of the breach of duty by the auditors.
212. Secondly, Advocate Dawes submitted that ‘misfeasance’ was given a wider meaning in legal dictionaries (e.g. *‘the improper performance of a lawful act, as where a person is guilty of negligence when performing a contract...’* Jowitt’s Dictionary of English Law), and in cases involving repair (or failure to repair) of the highway. We do not derive any assistance from the meaning of misfeasance in a different context. The word has to be interpreted in the context of Section 106 having regard to the meaning which has consistently been given to it in the equivalent English provision.
213. Finally, Advocate Dawes argued that one should have regard to the context and purpose of section 106, which was concerned with redressing losses to companies in liquidation occasioned by delinquent officers. The Court should therefore give the section a broad, rather than a narrow, construction so as to enable the section to be used effectively for the protection of creditors and shareholders of a company.
214. However, we have to apply the legislation in the form in which it has been enacted by the States. The equivalent English provision which was in force at the time of the enactment of the 1994 Law was section 212 of the 1986 Act. It is clear that, although the language differs in certain respects, Section 106 is based upon section 212. In particular, sub-section (1)(c) follows the wording of section 212(1) in referring to ‘misfeasance or breach of fiduciary duty’. However, for whatever reason, the States chose not to include the extension in section 212 to breach of any ‘other’ duty. We agree with the Lieutenant Bailiff at [642] that this must be taken to have been intentional. In those circumstances, we do not consider that we could properly depart from the established meaning of ‘misfeasance’ so as to include breach of the duty of skill and care when the States has elected not to do so.
215. In summary, therefore, we conclude that whatever the precise meaning of ‘misfeasance’ in section 106, it does not include a simple breach of the duty of skill and care. The Plaintiffs renewed before us an argument also made to the Lieutenant Bailiff to the effect that the concept of ‘misapplication of the company’s property’ extended not only to a wrongful disposition but also to a wrongful retention of property. It thus extended to the wrongful retention of RMBS in breach of the duty of skill and care in circumstances where the RMBS should have been sold. This argument was roundly rejected by the Lieutenant Bailiff at [637] and we entirely agree with her. The core allegation that the Defendants should have sold RMBS was a simple allegation of a negligent breach of duty in connection with the investment of CCC’s property. It does not involve any ‘misapplication’ of the company’s property and does not amount to ‘misfeasance’.

216. Accordingly, Section 106 has no application to the claims for breach of the duty of skill and care brought by the Plaintiffs. Its application is therefore limited to the allegations of breach of fiduciary duty by the Independent Directors.

(b) Does section 67F prevent reliance on article 172?

217. Our decision in relation to ‘misfeasance’ means that, even if we are wrong in upholding the Lieutenant Bailiff’s conclusion that there was no breach of the duty of skill and care, the Directors would be entitled to rely upon the protections contained in article 172 and accordingly would not be liable unless the Plaintiffs meet the higher threshold of proving wilful default or wilful neglect (which we have held they do not). This is because Section 67F only has effect if those claims fall within Section 106 as constituting misfeasance.

218. However, in case we are wrong on the interpretation of misfeasance (and because it is in any event relevant if, contrary to our view, the Independent Directors were in breach of fiduciary duty), we shall deal very briefly with the relationship between Section 106 and Section 67F. The reason for doing so briefly is not only because, on our findings, the matter does not arise, but also because it will not arise in future. That is because the 1994 Law (including Section 67F) has been repealed and replaced by the Companies (Guernsey) Law 2008 (“the 2008 Law”). Section 157 of the 2008 Law is in much more general terms and provides as follows:-

“Exempting directors from liabilities.

157(1) Any provision that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void.

(2) Any provision by which a company directly or indirectly provides an indemnity (to any extent) for a director of the company, or an associated company, against any liability attaching to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company of which he is a director is void, except as is permitted by sections 158 or 159.

(3) This section applies to any provision, whether contained in a company’s memorandum or articles or in any contract with the company or otherwise.

(4) ...”

This section would clearly have been sufficient to invalidate the protections conferred by Article 172, but it did not come into effect until 1st July 2008.

219. Section 67F only renders void an exoneration or indemnity provision which exempts or indemnifies a person from a liability (which would otherwise attach to him) under “*any provision of this Law under which personal liability may be imposed or incurred.*”

220. The question therefore is whether a liability which gives rise to a remedy under section 106 (because for example the person concerned has been guilty of misfeasance or a breach of fiduciary duty) is a liability ‘*imposed*’ by section 106.

221. The matter was considered by both the Royal Court (Collas DB) and this Court (reported at [2011-12] GLR 562) in earlier proceedings in the present case concerning the appropriate forum and the issue of whether leave to serve out of the jurisdiction on the non-resident Defendants should be set aside. At [62] of his judgment Collas DB said:-

“... section 106 is more than procedural; it does provide a remedy requiring a delinquent officer to contribute to a company’s assets. An order made under the Section requiring a delinquent officer to pay money or to contribute to the assets of the company does, in my view, ‘impose’ a personal liability on the delinquent officer and hence come within S.67F. That is the natural meaning of the words in the Law.”

222. The Court of Appeal considered the issue at [45] – [57] of its judgment (delivered by Beloff JA). We would quote the following two paragraphs:-

“51. As a result of the implementation of s.6 of the Companies (Amendment) (Guernsey) Law 1996... s.67F of the Companies (Guernsey) Law 1994 (as amended) provided, amongst other things, that company articles exempting persons from liability pursuant to ss.67A-67D or any other provision of the Law are void. Upon an ordinary interpretation of this provision, as the Deputy Bailiff used, it will embrace s.106, which imposes a liability. The fact that the same liability is imposed at common law, and that the section does not create a new liability, does not detract from the fact that the section imposes a liability if sought by certain persons in certain circumstances, and if deemed appropriate by the court in the exercise of its discretion. Such a result is not inappropriate, having regard to other considerations.

...

54. It was submitted for the directors that, by cross-reference to ss.29-30 of the 1994 Law (which imposed liabilities), s.106 could not properly be interpreted as resulting in the imposing or incurring of a liability. Such a contention cannot withstand the scrutiny of s.106: whilst the section does not create a new cause of action, it provides a procedure which, once properly instigated and duly accepted by the court, imposes a liability in such measure as the court should determine. The ultimate liability may (or may not) be the same as might have been imposed through common-law procedures based upon the same facts, but whilst the basis for the accrual of the cause of action would have been the same, the liability is determined upon, determined through and imposed by means of the statute.”

223. It was argued on behalf of the Appellants before the Lieutenant Bailiff that the issue was res judicata. The Royal Court and the Court of Appeal had determined that if the claims fell within section 106, the Directors would be unable to rely upon the exoneration and indemnity provisions in article 172 because of the effect of section 67F.

224. The Lieutenant Bailiff considered the position carefully and concluded at [670] that the issue before Collas DB and the Court of Appeal was whether there was an arguable claim for the purposes of the forum issues which the Court had to decide and that neither Court had made a final decision on the point. We think she was entitled to reach that conclusion.

225. She then considered whether she agreed with the Court of Appeal’s views as expressed in its judgment to which we have referred above. She did not express a final conclusion but indicated a clear preference for the Respondents’ argument. That argument was repeated before this Court. The Respondents submitted that, at any rate in relation to an exoneration clause, a provision such as article 172 has the effect of negating what would otherwise be a cause of action. In other words, it prevents any cause of action arising in the first place. Advocate Swan in dealing with this argument referred us to the decision of the Privy Council in Viscount of the Royal Court of Jersey -v- Shelton [1986] 1 WLR 985 at 991F ... “A company has no cause of action against a director in respect of a matter against which the company has agreed to indemnify him”; and the decision of this Court in Emerald Bay Worldwide Limited -v- Barclays Wealth Directors

(Guernsey) Limited 9th January 2014 at [43] “... that the effect of such clauses is, whether construed as exclusion clauses or more narrowly as indemnities, to exclude the other contracting party from responsibility.”

226. The Respondents went on to argue that, as section 106 does not create any new cause of action but only operates to provide an alternative remedy for an extant cause of action, it is necessary for there to be an extant cause of action for the section to operate. As the effect of the exoneration or indemnity clause is to extinguish the relevant cause of action, the conclusion has to be that there is no extant cause of action, nothing for section 106 to operate on and therefore, by extension, no scope or trigger for the operation of section 67F.
227. The Lieutenant Bailiff did not reach a final decision on whether an exoneration clause prevents any cause of action from arising in the first place but held that, if it did, she would accept the Respondents’ argument. In expressing this conclusion, the Lieutenant Bailiff said she was conscious that the Court of Appeal had expressed a different view but respectfully considered that the Court of Appeal had not had the point summarised in the preceding paragraph made to it during the course of the forum appeal.
228. We see the logical force of the Respondent’s argument if it is accepted that the effect of an exoneration clause such as that contained in article 172 is to prevent any cause of action arising in the first place. But, even if this is so, had we been called upon to decide the issue we would nevertheless have followed the views expressed by this Court in the judgment of Beloff JA for the reasons which he gives at [51] and [54] as set out above. Furthermore, if the Respondents’ argument is accepted, it would render section 67F wholly ineffectual in relation to section 106. No matter how clear any breach of fiduciary duty or misfeasance, any appropriately worded exoneration clause would prevent a cause of action arising in the first place so that (on this argument) section 106 would never come into play. Yet it is clear that section 67F was intended to prevent such exoneration clauses from having effect in respect of any liability ‘imposed’ by any provision of the 1994 Law including section 106. Thus the very exoneration clause which section 67F is intended to invalidate would, if the Respondents are right, prevent section 67F having effect. We do not think that such an unsatisfactory result is mandated by the language of the statute.
229. Accordingly, we hold that, by reason of section 67F, the exoneration and indemnity provisions contained in article 172 would not have the effect of preventing any liability to the liquidators in respect of (i) any breach of fiduciary duty by the Independent Directors or (ii) any breach of the duty of skill and care by any of the Directors if such breach amounted to ‘misfeasance’.

Other matters

230. Article 174(2) of the articles of CCC provides as follows:-

“Any matter that is approved by a majority of the Independent Directors will not constitute a breach of any duties stated or implied by law or equity, including fiduciary duties....”

231. Before the Lieutenant Bailiff, the Appellants raised a number of arguments as to why the Directors could not rely on this provision, including a suggestion that it was void as being contrary to public policy.
232. At [711] the Lieutenant Bailiff said that these arguments had not been the subject of oral submissions in the interests of time. She said that she would only consider the arguments if it became necessary and would invite further submissions if she thought it appropriate. She did not then consider the point further in the remainder of her judgment as it was not necessary to do so

in the light of her findings that there was no breach of the duty of skill and care or breach of fiduciary duty. Similarly, although the parties addressed the point concerning article 174(2) in their written submissions to this Court, we heard no oral submissions. In the circumstances, given our conclusions on the various other issues, we have not considered article 174(2) further.

233. The Directors also asserted before the Lieutenant Bailiff that, if it became necessary, they would seek to invoke the Court's statutory discretion under section 522 of the 2008 Law to excuse a director from liability on the grounds that he "*acted honestly and reasonably ... and ought fairly to be excused*". In the light of her conclusions, not surprisingly the Lieutenant Bailiff did not consider this matter further in her judgment.
234. We have had brief written submissions on the point but again no oral argument was addressed to us. We therefore express no final conclusion although, if we had found the Directors to be in breach of their duty of skill and care and/or in breach of fiduciary duty and that such breaches had caused substantial financial loss to CCC, we would have required considerable persuasion that section 522 ought to be invoked.

Summary of conclusions

235. We would summarise our conclusions as follows:-

- (i) We uphold the Lieutenant Bailiff's decision that the Directors were not in breach of their duty of skill and care or of their fiduciary duty and that CIM was not in breach of its contractual obligations under the Investment Management Agreement or of its obligations in tort.
- (ii) If we had found the Directors to be in breach of duty, we would have decided as follows on the various points which were raised under the heading of 'Possible Defences':-
 - (a) Articles 172 and 174(2) were incorporated in the terms of service of the Directors.
 - (b) The Directors were not guilty of wilful default or wilful neglect so that, prima facie, the protections conferred by article 172 would have effect even if the Directors were in breach of their duty of skill and care and/or fiduciary duty.
 - (c) However, Section 67F has the effect of preventing the Directors from relying on the protections conferred by article 172 (or article 174(2)) to the extent that any breaches of duty amounted to 'misfeasance' or breach of fiduciary duty.
 - (d) The alleged breaches of the duty of skill and care did not amount to misfeasance within Section 106, with the result that section 67F has no application and therefore the protections conferred by article 172 would have effect in relation to those breaches. However, the protections conferred by article 172 (and article 174(2)) would not have effect in relation to any liability to the liquidators arising from breaches of fiduciary duty (or any misfeasance if proved), as section 67F renders void the protections conferred by those articles in relation to such breaches.

236. For the reasons we have given, we dismiss this appeal.

