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Judgment in insolvency claims brought against BHS directors

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On 11 June 2024, the judgment of *Re BHS Group Limited (In Liquidation) (BHS)* was handed down by Leech J in the English High Court, bringing in key developments and clarifications on directors' duties in the zone of insolvency.

This is especially relevant in offshore jurisdictions such as Guernsey where English insolvency legislation is often replicated in local legislation. English common law remains highly persuasive in relation to directors' duties and claims by liquidators against former directors are relatively common.

Summary of claims

The liquidators of high street shopping chain BHS brought claims against the former directors of companies in the BHS Group pursuant to the Insolvency Act 1986 and the Companies Act 2006 for wrongful trading, "trading misfeasance" (a novel term), and breaching duties to creditors.

On the wrongful trading claims, the liquidators alleged that the directors continued to trade and failed to place the companies into administration when they knew or ought to have known (based on six alternative knowledge dates) that there was no reasonable prospect of avoiding insolvent liquidation. This claim was upheld in respect of the latest date of knowledge of 8 September 2015.

On the trading misfeasance claims, the liquidators alleged that the directors breached their duties to creditors by entering into loan facilities when the company was insolvent or bordering on insolvency or a liquidation procedure was probable (which is a step before it becomes unavoidable). Five of the eight trading misfeasance claims were dismissed on grounds of causation and liability for the remaining claims was held to have arisen from June 2015 (prior to the date of knowledge in the successful wrongful trading claim).

The liquidators claimed damages in excess of £160 million due to the alleged delay in administration (of just over a year). Liability on the claims was based on differing levels of culpability and directors found liable were ordered to contribute £6.5 million each to the companies' assets and equitable compensation of circa £5.4 million.

The liquidators also made individual misfeasance claims, with four out of eight (again) failing on causation. The liquidators were successful in another claim for an alleged breach by one of the directors of his statutory duty not to accept benefits from third parties. He failed to account to the companies for a payment received of £300,000 and was ordered to repay that sum.

Noteworthy findings

Wrongful trading

Knowledge condition: A director has a duty to obtain sufficient financial information to monitor the company's solvency, and in determining the knowledge condition in a wrongful trading claim, the Court may consider any material which the director could have accessed with reasonable diligence. Accordingly, the Court can assume that a director is aware of the company's financial results, at least to the extent of the size of any deficiency of assets over liabilities.

Assessing liability: The liability of a director for wrongful trading is assessed by the increase in the net deficiency in the assets caused by continuing to trade from the date on which the knowledge condition is met until the date on which the company goes into insolvent administration / liquidation.

Delegation of duty: A director has an inescapable duty to supervise fellow directors and exercise independent judgment, and delegating decisions reserved for the Board is a breach of duty. For example, it is a director's duty (and not that of his legal advisor) to decide whether there is a reasonable prospect of avoiding insolvent liquidation. Despite none of the companies' advisers giving advice that there was no such reasonable prospect, the Court attached limited weight to the advice due to the directors' lack of careful consideration of the advice and failure to apply their minds to the decisions. In other words, legal advice will not be as helpful in defending such a claim if it was obtained as a box-ticking exercise and if the lawyers and/or insolvency practitioners do not have the full picture as regards the financial affairs.

Trading misfeasance

This claim is based on a breach of the directors' duty to creditors which arises where the company is either insolvent, bordering on insolvency or an insolvent liquidation/ administration is probable. It is a breach of this duty for a director to fail to consider the interests of creditors by engaging in "insolvency-deepening activity" and failing to place the company into administration/ liquidation. Liability for trading misfeasance can arise even before insolvent liquidation has become inevitable and where there is thus no liability for wrongful trading at that stage.

The judgment provides a good example of what may be construed as "insolvency-deepening activity", in this case where directors entered into onerous and expensive finance transactions and had "last desperate throws of the dice" while the creditors took all the risk.

The Court left the question open as to whether there is a knowledge requirement for a trading misfeasance claim (that is to say, that the directors knew or ought to have known that insolvency was probable). However, the fact that the Judge made findings on the directors' knowledge suggests that this requirement likely applies.

Compensation

When assessing the level of compensation, the Court will not take into account a director's impecuniosity or inability to make payment (for example, based on deficiencies in the insurance cover or insufficient level of personal assets), even if it could be potentially ruinous. This is due to the impact this would have on creditors and the "green light" this would give to risk-taking or even dishonesty.

Conclusion

This judgment warns that the duty to creditors (previously confirmed in the landmark judgment of *BTI 2014 LLC v Sequana SA* [2022] UKSC 25) can be used as the basis for a judicially developed claim of "trading misfeasance", with a lower evidentiary threshold, earlier trigger date for liability (three months in this instance) and potentially significantly higher quantum than in wrongful trading. It also urges directors to closely and continuously monitor the company's financial position and to carefully, cautiously and independently consider any steps taken to continue to trade where any risk of probable insolvency is identified, even with robust legal advice in place. The importance of this decision to directors of Guernsey companies, especially those showing early signs of distress, cannot be understated.

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