

A&O SHEARMAN

Liability for "misfeasant trading" – guidance from the latest BHS judgment

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Following the judgment of the High Court in June 2024 finding two former directors of BHS liable for (amongst other things) wrongful trading and breaches of their directors' duties to creditors in the prelude to the insolvency of the BHS group^[1], Mr. Justice Leech has issued a new [judgment](#)^[2] on 19 August 2024 which assesses the quantum of liabilities attributable to the breach of duty claim (so-called "misfeasant trading").

Summary

The court has found that Dominic Chappell and Lennart Henningson are jointly and severally liable to pay equitable compensation of a total amount of GBP110.23 million to BHS, based on the "increase in net deficiency" (IND) of assets suffered by BHS in the period of time between (a) the date on which the directors ought to have concluded that it was more probable than not that BHS would go into insolvent administration, that the interests of creditors was paramount, and that it was in the best interests of creditors to put BHS into administration immediately (23 June 2015); and (b) the date on which BHS entered into insolvent administration proceedings (25 April 2016).^[3]

Mr. Justice Leech did also make two alternative findings in the event that his original judgment is held to be incorrect on appeal – (a) equitable compensation awarded on the basis of individual components of the IND rather than the total IND (which would amount to a total liability of GBP88.93 million), and (b) equitable compensation awarded by reference to individual transactions taken in breach of the applicable directors' duties (which would amount to a total liability of GBP34 million).

The scale of the award underlines (again) the importance of the "shift" in a director's ordinary duty to promote the success of the company for the benefit of its shareholders towards prioritising the interests of the company's creditors as a company becomes more and more financially distressed and edges closer to insolvency. Directors of companies encountering potential financial difficulties would be well advised to procure professional financial and legal advice at the earliest opportunity to seek to minimise any potential losses to creditors as a result of taking operational and rescue decisions during such period of financial stress.

Key takeaways for directors

Remedy for breach of duty

The remedy for breach of duty is essentially a form of restitution (referred to as "equitable compensation"), intended to restore the assets lost to the company as a result of the duty breach.^[4]

Did the breach of duty cause the loss?

The Court will apply a "but for" test when assessing losses arising from a breach of duty (i.e. if the losses would have happened in any event, then the relevant breach cannot be said to have caused the loss). Once causation has been established however, the quantum of equitable compensation is assessed with the full benefit of hindsight (taking a common sense view) and questions as to whether the losses were foreseeable at the time of the breach in question (known as the "remoteness" principle) do not apply.

Calculating the quantum of loss

The starting point for determining the scale of loss caused by misfeasant trading is the IND of a company's assets over the entire period that a company continues to trade, rather than being limited to losses arising from the single transaction or venture which the relevant director authorised in breach of their duties, where the purpose of the relevant transaction/venture was in fact to enable the company to continue to trade. However, it must be shown that the breaches of duty were "not simply the occasion for the losses which the company has suffered by continuing to trade but an effective cause (but not the sole or only effective cause)". For example, in this case, the Court held that the breach of the directors' duties was not an effective cause of an increase in a BHS group pension deficit, with the amount of such increase being deducted from the total IND attributable to the directors' breach.

Joint and several liability

Where directors have been involved in a collective breach of their duties, the Court will likely hold the directors to be jointly and severally liable for the resulting losses^[5], albeit there was some debate in this case as to whether the Court could exercise a discretion to impose liabilities on a several basis only. This question was ultimately left unresolved – the judge assumed that such a discretion existed, but exercised it so as to impose liabilities on a joint and several basis anyway.

Wrongful trading vs "misfeasant trading" – potential overlap?

The remedy for misfeasant trading awarded in this case (i.e. the IND of a company's assets over the entire period that a company continues to trade) is identical to that available for wrongful trading. Unlike misfeasant trading, liability in respect of wrongful trading is subject to a strict "knowledge test" (i.e. that the directors knew, or ought to have known, that there was no reasonable prospect of the company avoiding insolvent liquidation or administration). Counsel to Mr. Henningson submitted that insolvency officeholders may in the future try to "shoe-horn" what should be wrongful trading claims into misfeasant trading claims in order to bypass the knowledge test. Mr. Justice Leech noted the different legal requirements of the two heads of liability but affirmed that the measure of loss for each may be the same^[6], and that the fact that liability for losses under misfeasant trading must fall within the scope of the relevant directors' duties which have been breached will provide an "adequate control mechanism to limit the overlap".

Footnotes

[1] For further details, please refer to our previous alert on this matter here.

[2] Wright and Rowley, BHS and others v Chappell and others [2024] EWHC 2166 (Ch).

[3] Another former director of BHS, Dominic Chandler, reached a settlement with the liquidators of BHS after the first judgment in this matter was handed down, and so was excluded from the award of liabilities made in this latest judgment.

[4] Target Holdings Ltd v Redfern [1996] AC 421; AIB Group (UK) plc v Mark Redler & Co [2015] AC 1503; Liberatarian Investments Ltd v Hall [2013] H.K.C.F.A. 93.

[5] Re Duckwari plc [1999] Ch 253.

[6] Re Purpoint Ltd [1991] BCC 121 and Brooks v Armstrong [2016] BPIR 272