BHS directors ordered to pay over £100m in respect of trading misfeasance redress

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On 19 August 2024, the High Court handed down its quantum decision in Wright v Chappell [2024] EWHC 2166 (Ch), which for the first time sets out the method for quantifying loss relating to "trading misfeasance" claims.

Introduction

On 11 June 2024, the High Court dealt with liability and causation in respect of wrongful trading and trading misfeasance claims brought by the Liquidators of British Homes Stores (**BHS**) Group against the company's former directors. The Court considered "trading misfeasance" as a cause of action, which is a term that the Court has coined to refer to a director's failure to consider the interests of creditors when a company is insolvent or bordering on insolvency, which they nonetheless continue to trade. Quantum was also dealt with in the June judgment, bar in relation to the trading misfeasance claims, which was reserved to the August judgment. This was on the basis that given this is a developing area of law, the Court did not want to impose liability on the directors until they had the chance to make further submissions, before they looked to consider compensation for breach of what the Court has described "the modified Sequana duty" (see below).

The Supreme Court decision in Sequana

The leading case dealing with the scope of duty owed to creditors for directors of companies in financial distress is *BDI 2014 LLC v Sequana SA and others* [2022] UKS C25 (**Sequana**). The Sequana case established the duty to consider creditors' interests arises when directors know, or should know, that the company is insolvent or bordering on insolvency or that insolvent liquidation or administration is probable. We discuss the case in more detail in our blog.

We have also previously discussed the potential increase in claims against directors and officers (**D&Os**) resulting from this decision, and the decisions that have followed it in our blog - How a Supreme Court ruling could cause surge in claims against directors.

In *Wright v Chappell* the High Court ultimately held that directors of the former BHS group of companies were jointly and severally liable for £110,230,000 in respect of their breaches relating to the trading misfeasance claims. As such, the quantum decision serves as a timely reminder of a director's duty to carefully consider any transactions, and the potential liability that will arise from a failure to do so, which we explain in more detail below.

Background – Wright v Chappell

In April 2016, four companies in the BHS group went into administration, requiring the instruction of joint liquidators.

Shortly after their instruction, the joint liquidators determined that, from the date of their appointment, the directors either knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation. The joint liquidators subsequently brought claims against the four directors involved. One director settled their claim with the joint liquidators.

One claim was made for wrongful trading under section 214 of the Insolvency Act 1986 (the **1986 Act**), where the Court ultimately determined that the directors were each liable on a joint and several basis for a 15% share of the net deficiency between the date on which the Court determined the directors knew or ought to have known there were no reasonable prospects of avoiding insolvent liquidation and the date on which BHS eventually filed for administration.

The second claim, being the claim for which the recent judgment on quantum has been handed down, was a claim under Section 212 of the 1986 Act, or what is now being termed as "trading misfeasance". The Court found that the directors did not have regard to their fiduciary duties and as was established in the Sequana case, the duty to have regard to the interests of creditors.

The August quantum decision

The Court's August judgment dealing with the quantum for the trading misfeasance claim set out a framework for calculating redress resulting from this relatively new cause of action.

Interestingly, the Court determined that Section 212 was engaged on any date on which the directors had a duty to consider if a transaction was in the interests of creditors, but ultimately failed to discharge that duty. This led the Court to determine that the date from which the increase in net deficiency would be calculated would be June 2015, which was c.3 months earlier than the relevant date in the wrongful trading claim.

In assessing causation, the Court applied a "but for" test: but for the directors' decision to continue to operate the company, would the creditors of the company have been better off than they ultimately were at the point of administration?

This approach was applied to the directors on a joint and several basis, exposing the directors to a much greater liability than the wrongful trading findings in the first claim.

In assessing the scope of the loss, the Court dismissed the defendants' arguments that the measure for compensation should be limited to the specific single malfeasant transaction or venture. Instead, the Court applied a much wider scope, finding that the starting point for calculating the increase in net deficiency was when the directors entered into a transaction which allowed the companies to continue trading contrary to the interests of creditors. In essence, the directors were joint and severally liable for the difference between the company's assets and liabilities at the point they entered into the additional loans and the point at which the company was put into administration.

Interestingly, the Court did not apply the principle of remoteness, but did find that it was still necessary to prove that any breaches of duty were the effective cause of the losses suffered. The Court also considered the scope of the directors' duty, finding that losses unrelated to the breach of duty would not be recovered. This meant that the impact on the company pension fund, caused by market fluctuations, was deemed outside the scope of the duties breached by the directors and so these losses were not recoverable.

Key take-aways

It has been nearly two years since the Sequana decision and in that time the Courts have sought to further clarify the application of the principles set out in that decision, such as in the case of *Hunt v Singh*, which we discussed in a blog post last year. The recent BHS case has therefore added further clarity to a newly developing area of law.

While *Wright v Chappell* represents an extreme version of events, it emphasises the need for directors to carefully consider any transactions they propose to make, and to be able to demonstrate a well-reasoned basis for those transactions.

D&Os should continue to keep a close eye on the developing caselaw surrounding the management of companies in the insolvency area.

To read the *Wright v Chappell* judgments, please click here and here.