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Multimillion-Pound Personal Liability for Former BHS Directors for Wrongful Trading and Misfeasance

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Summary

In June and August of 2024, the High Court published judgments holding that three former directors of British Home Stores Group ("BHS") were liable for wrongful trading, individual misfeasance and trading misfeasance relating to the collapse of BHS in 2016.

In June 2024, the Court ordered that two of the directors—Lennart Henningson and Dominic Chandler—pay approximately £10.5 million and £8.1 million respectively to the joint liquidators of BHS in respect of wrongful trading and individual misfeasance claims (the "June Decision"). Due to a late adjournment application, a third director, Dominic Chappell, was not party to the June 2024 judgment. Judgment on the quantum of a trading misfeasance claim was reserved until August 2024.

Shortly after the June Decision, Mr Chandler entered into a settlement with the joint liquidators under which he agreed to pay £730,000 in respect of all claims against him. Around this time, the joint liquidators also sought and obtained summary judgment against Mr Chappell so that he became, in effect, bound by the findings in the June Decision.

The second part of the proceedings took place in August 2024 and dealt with quantum issues arising from claims of trading misfeasance against the directors. The Court invited submissions on how compensation for the increase in BHS's net-asset deficiency from the end of June 2015 until the date BHS was placed into administration should be calculated. The Court held that Mr Henningson and Mr Chappell, the two directors remaining involved in the proceedings, were jointly and severally liable for more than £110 million in relation to the trading misfeasance claim (the "August Decision").

Brief Factual Background

In March 2015, Retail Acquisitions Limited ("RAL") purchased BHS and appointed new directors. Prior to this time, BHS had been in significant financial difficulties; RAL paid only £1 for BHS.

In May/June of 2015, BHS entered into new financing arrangements on very onerous terms. The Court later determined that by this time, the directors ought to have known it was more probable than not that BHS would enter into insolvent administration. By September 2015, the BHS group of companies were cashflow insolvent. The Court found in its judgment that by this time, the directors knew or ought to have known that BHS had no reasonable prospect of avoiding insolvent liquidation or administration.

Notwithstanding the directors' knowledge, BHS continued to trade.

In March 2016, creditors of BHS approved a company voluntary arrangement, but by April 2016, it was apparent that BHS would be unable to secure the financing required under the voluntary arrangement, and four BHS group companies entered administration. Joint liquidators were appointed.

Proceedings were eventually commenced by the joint liquidators in 2020 against four former directors of BHS, two of whom (Mr Henningson and Mr Chandler) remained parties at the point at which the matter went to trial.

Issues at Trial

The claims against the directors fell into two categories:

- Wrongful trading; and
- Misfeasance.

Wrongful Trading

A liquidator may apply for a declaration that a director (or former director) of a company is liable to make a contribution to the company's assets where it becomes apparent in the course of a winding up that the director engaged in wrongful trading.

Wrongful trading under section 214 of the Insolvency Act occurs where a director of a company that has gone into insolvent liquidation knew, or ought to have concluded,

that there was no reasonable prospect that the company would avoid insolvent liquidation or administration. A director has a defence to, and may avoid liability for, wrongful trading if they can show that from the date of knowledge, they took every step with a view to minimising potential losses to the company's creditors.

In determining whether a director has the requisite knowledge, the joint liquidators had to establish that the directors had no rational basis for continuing to trade, with the test of knowledge applied to each director based on their individual involvement rather than the knowledge of the board as a whole. The directors had to have known, or ought to have known, that insolvency liquidation was inevitable in order to be liable under section 214. However, the Court noted that "*blind optimism or micawberism is not sufficient to defeat liability*".

The joint liquidators identified a total of six different dates as potential "knowledge dates" on which they alleged that the directors of BHS had had the requisite knowledge such that they became liable for wrongful trading. The first such date was approximately one month after the acquisition of BHS by RAL; the last was approximately six months after the acquisition, in September 2015.

The Court ultimately found that the last date, 8 September 2015, was the date on which the directors first had the requisite level of knowledge under section 214 of the Insolvency Act. This was approximately seven months prior to BHS going into administration, during which time BHS had continued trading.

In considering whether the directors could avail themselves of the defence available in section 214(3), the Court noted that the provision "imposes a high hurdle to overcome", and:

"*It is not enough for the directors to prove that they continued trading with the intention of reducing the net deficit of the company. They must show that it was designed to minimise the risk of loss to individual creditors.*"

The June Decision noted that counsel for Mr Henningson and Mr Chandler submitted that the only proper steps which the directors could reasonably have taken were to seek insolvency advice from lawyers and financial advisers shortly after each of the alleged "knowledge dates" and then put the BHS group companies into insolvency shortly after each date. The Court rejected that argument in the June Decision, noting that the standard of "every step" will depend on the facts of each case, though it would be helpful to directors in general terms to show that they had taken and followed legal and/or financial advice. The ultimate responsibility for decision-making, however, lay with the directors and not with their advisors.

Having considered the directors' conduct during the period between September 2015 and the decision to put the BHS companies into liquidation (including the fact that they had taken professional advice), the Court determined that they had not in fact taken "every step" towards minimising losses to BHS's creditors. No defence was available to the directors, and Mr Henningson and Mr Chandler were found liable for wrongful trading.

Misfeasance

Under section 212 of the Insolvency Act, if, in the course of a winding up, it appears that a director 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, the Court may order the director to repay, restore or account for money or property with interest or contribute to the company's assets by way of compensation.

In showing misfeasance for the purposes of section 212, the joint liquidators relied on various provisions of the Companies Act 2006:

- Section 171, which provides that a director must act in accordance with the company's constitution and only exercise powers for the purposes for which they were conferred;
- Section 172, which provides that directors must in act a way that they consider, in good faith, would be most likely to promote the success of the company;
- Section 173, which requires that directors exercise independent judgment;
- Section 174, which imposes a duty on directors to exercise reasonable care, skill and diligence;
- Section 175, which imposes a duty on directors to avoid unauthorised conflicts of interest; and
- Section 176, which provides that directors must not accept a benefit from a third party conferred by doing or not doing anything as a director if the benefit is likely to give rise to a conflict of interest.

On the facts of the case, the Court found that there had been various breaches of these provisions connected to BHS entering into overly onerous financing arrangements in May/June 2015 and to BHS selling a commercial property at an undervalue.

The Court's most notable finding on misfeasance arose in respect of what has been described as "trading misfeasance", referring to the directors' decision to keep BHS trading when it was close to insolvency, contrary to section 172 of the Companies Act.

As noted above, pursuant to section 172 of the Companies Act, directors must promote the success of the company. As was noted in *BTI v Sequana*,[1] when a company is insolvent or bordering on insolvency, or an insolvent administration or liquidation is probable, a director's duty under section 172 will include promoting the interests of the creditors as a whole. The worse the company's financial position becomes, the more the directors should prioritise the interests of creditors.

On the facts, the Court determined that the board did not consider the risks to individual and unsecured creditors of BHS continuing to trade. Had the board properly considered the interests of the creditors, they ought to have concluded that it was in the creditors' interests to put the company into administration. The directors had not therefore complied with their duties under s.172 of the Companies Act.

The various breaches of the directors' duties under the Companies Act were breaches of duties giving rise to liability on the part of the directors to contribute to the company's assets under s.212 of the Insolvency Act.

The directors sought to be relieved from liability under s.1157 of the Companies Act, which empowers a court to relieve a director from liability if it appears that the director had acted honestly and reasonably, and having regard to all the circumstances the director ought fairly to be excused. The Court determined that having regard to all the circumstances, the directors ought not to be excused from liability.

Damages Awarded in June 2024

After deciding on the merits, the Court ordered that Mr Henningson and Mr Chandler pay £6.5 million each in respect of the findings of wrongful trading.

In connection with the various acts of individual misfeasance, the Court ordered that Mr Henningson pay approximately £4 million, and Mr Chandler pay approximately £1.67 million.

[1] *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25.

The directors had argued that liability should be capped at the level of Directors and Officers ("D&O") insurance cover the company had, or at the amount the directors could afford. The Court rejected this argument.

In light of the fact that "trading misfeasance" was a developing area of law and that there was a very significant amount of money at stake, Leech J reserved judgment on quantum for that claim.

August 2024 Quantum Hearing

There were two significant developments following the High Court's principal judgment of 11 June 2024.

In an oral judgment on 25 June 2024, Leech J held that a third director, Dominic Chappell, was bound by admissions under CPR Part 16.5 and had no real prospect of defending the claims against him. On this basis, Mr Chappell was also held to be liable for trading misfeasance, individual misfeasance and wrongful trading. He was ordered to pay £21.5 million in respect of the wrongful trading and individual misfeasance. As with the other directors, judgment on the quantum of the compensation for trading misfeasance was reserved.

Having dealt with liability and causation in the June Decision, the Court in the August Decision addressed the quantum of liability for Mr Henningson and Mr Chappell in relation to the trading misfeasance claim. This was the first recorded decision on the quantum of equitable compensation for "trading misfeasance" following *BTI v Sequana*.

Leech J outlined the following framework for evaluating the quantum for claims of trading misfeasance:

- The starting point is that the directors will be liable for the increase of the net deficiency in the company's assets ("IND") between (i) the date on which they ought to have concluded that it was more probable than not that the company would go into insolvent administration and that it was in the best interests of the company's creditors that the company go into administration; and (ii) the date on which the company *actually* went into administration.

- The calculation of the IND should relate to the entire period that a company continued to trade and is not limited to losses arising from a specific or singular transaction which a director wrongly authorised.

- It is not sufficient for the liquidators to show that but for the breach of duty, the IND would not have occurred. They must prove that the breach was an effective cause of the losses which the company suffered. It is not, however, necessary to prove that the breach of duty was the sole or only effective cause.

- The court has a discretion as to whether to impose liability on a joint and several basis.

Applying this framework, Leech J noted that there was a strong nexus between the directors' misfeasance and BHS's IND and held that the directors' decision to continue trading in June 2015 was an "effective cause" of almost all of BHS's IND. The only exception to this was the increased shortfall in BHS's pension scheme. The Court held that this was not caused by the directors' misfeasance, since the value of the pension scheme was inherently volatile.

As outlined above, the Court considered that calculating the total IND was the starting point for assessing the quantum of equitable compensation to be paid by the directors. The parties had agreed that the total IND for the period between 26 June 2015 (when the directors knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation or administration) and 25 April 2016 (when BHS was placed into administration) was £133.46 million. From this figure, the Court deducted the increase to the shortfall in BHS's pension scheme (£19 million) and amounts paid in compensation by other directors (£4.23 million). This left a total of £110,230,000, for which the Court held Mr Henningson and Mr Chappell jointly and severally liable. Leech J also made findings as to what the quantum of compensation should be on two alternative methods in case it was later found that his primary approach was wrong.

The approach taken by the Court in the August Decision reflects a relatively expansive approach to quantifying damages in this context and opens the door for very large awards in relation to directors who breach the "Sequana duty". The judgment in *Wright v Chappell* reinforces that, as soon as there is a hint of potential insolvency, directors must seek professional advice and consider their duties very carefully, including their duties to creditors of the company.

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