D&O Claims Case Update: BHS Liquidators Succeed in D&O Claim against former directors

1. In 2016 the collapse of the once much-loved BHS retail chain filled the financial pages. The disaster was all the more salacious when it became known, to the shock and astonishment of many, that in 2015 BHS had been sold for £1 on a debt-free basis to Dominic Chappell, a man who had been bankrupt 4 times before and who had no experience of running a retail business.

2. In the aftermath of the failure a number of enquires took place and several pieces of litigation began. One of them involved a claim by the liquidators against the former directors for wrongful trading and misfeasance. The lengthy judgment on these claims was handed down in the Chancery Division on Tuesday and, although the facts are spectacular and unlikely to frequently reoccur on quite the same scale, many of the aspects of the case are encountered in more everyday D&O claims. As a result, the Judge's handling of them is worthy of careful consideration.

3. This note will briefly summarise the legal principles as decided by the Judge (Mr Justice Leech), with paragraph references so that the interested reader can jump straight to those passages. It will then comment on some of the issues which tend to re-occur.

The Law

Claim 1: Wrongful Trading

4. A director may be personally liable for a company's losses if, prior to the insolvent liquidation, the directors ought to have concluded that there was no reasonable prospect of the company avoiding such a fate and they did not take every step to minimise the potential loss to creditors [**463**]. This is called wrongful trading.

5. The Judge summarised the law in some detail [**466**]:
   a. the standard of reasonableness expected of directors is not just a question of job title: active non-execs can be treated as if they were executives, and if you are a director of a large and sophisticated company then you will be held to the standard to be expected of a person fulfilling that role.
   b. A director will be treated as having the knowledge which s/he had, or could have had.
   c. A company may be insolvent, yet a director may reasonably consider that it will trade out of this position, but there needs to be a rational basis for this belief, rather than simply blind optimism.
   d. In applying the recent BTI v Sequana decision of the Supreme Court, the Judge held that, in order to prove that the directors were liable for wrongful trading, the liquidators needed to prove that the directors knew that insolvent liquidation (or administration) was inevitable [**473**].

6. What about reliance on expert directors or expert advisors? Often individual directors might rely on the Finance Director or the external accountants. Can that constitute a defence? The Judge doubted that directors could properly rely entirely on fellow directors, and said that, although professional advice might be relevant, it would depend on the precise circumstances, including what the experts were asked to do, what they were told and what they said [**480 – 486**]. In this

particular case the fact that different directors had different responsibilities did not reduce their share of the damages [**1145**].

7. The losses potentially recoverable are those which were caused by the continued trading, so losses which would still have accrued even if there had been an earlier insolvency are stripped out [**493, 497**].

Claim 2: Misfeasance

8. The duties of directors are numerous and set out in the 2006 Act. A director must: act within their powers [**521 – 532**], promote the success of the company [**533-546**], exercise independent judgment [**547, 548**], act with reasonable skill and care [**549 – 551**], avoid conflicts of interest [**552 – 553**], and not accept benefits from third parties [**554 – 564**].

9. A liquidator may bring a claim against a former director for misfeasance where the director is in breach of those duties.

10. The losses recoverable in such a claim will be those that were caused by the misfeasance, and in testing this the Court will determine (a) what would have happened had the director complied with their duties, and (b) what actually happened [**502-505**].

Practical Points

Professional Advisors

11. Grant Thornton were engaged by BHS to give financial advice. They charged a seven figure sum for this. The directors pointed out that GT never said that there were no reasonable prospects of avoiding insolvent liquidation, and argued that, as a result, the directors should not be held liable. The Court did not accept that on the facts, and said that ultimately the responsibility was on the directors to comply with their duties as directors [**908-912**]. Numerous other expensive and expert advisers were also involved and gave advice on wrongful trading, directors' duties and in relation to various transactions. The Court made similar findings. The takeaway is that, although substantial companies often have a range of professional advisors involved, the Court made clear that this does not necessarily count as a shield.

Sympathy

12. One of the defendant directors, Mr Chandler, was general counsel and earned about £250k as such. By training he was a criminal barrister and he did not have the experience to be expected of a general counsel of a group like BHS [**858**]. The Judge found that he was honest and did his (incompetent) best. He ended up being ordered to pay at least £6.5m and the Court recognised this would probably bankrupt him. In these cases, sympathy does not get one very far.

Causation

13. In relation to various specific transactions which the directors passively went along with, and in relation to which the liquidators proved that the directors were in breach of duty, the Court held that even if the relevant director had complained or objected the controlling director (Mr Chappell) would have pushed the transactions through. Thus, on these transactions, the liquidators failed to establish causation [**1115-1121, 1126**]. So it is important to properly think

about what would have happened, if there had been no breach of duty, in passive director transactions.

Relevance of insurance

14. The directors had £20m of D&O cover. The Court declined to take that into account in reducing the contribution which the directors were required to make [**1146 -1149**]

Share of Liability

15. The Court held that Mr Chappell ought to have 50% notional liability and the other directors were then equally liable for the rest on a several, not joint, basis. It considered that this was fairer having regard to their different roles and culpability [**1142**]. So when defending these claims it might often be necessary for each director to have separate representation.

Misfeasant Trading?

16. The Judge also found that directors could be liable for trading losses when they ought to have considered that the interests of creditors justified an insolvency process. He found that a time came when the directors ought to have concluded that it was probable but by no means inevitable that BHS would go into insolvent administration. He also found that the directors did not, in good faith, consider the interests of these creditors at that time. Therefore this was a breach of their duties for which they were liable [**982-992**].

17. This amounts to treating ongoing trading as a misfeasance/breach of director's duty claim. It seems to cut around the specific tests for wrongful trading (in particular the need for knowledge that liquidation/administration is inevitable). The loss claimed by the liquidator was the whole of the increase in the deficit but the Court was not sure about that [**1132**]. This novel liability is one which liquidators will no doubt seek to rely on (if it is upheld on any appeal).

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