Briefing

BURGES SALMON

Corporate Turnaround and Insolvency

April 2016

Director liabilities in the spotlight – a trio of cases on wrongful trading and misfeasance

Actions for misfeasance and wrongful trading are somewhat of a lottery. Although it can often seem blindingly obvious to the casual observer where blame lies, actually proving the same in court produces mixed results, even when there are remarkably similar factual backgrounds. This article analyses three such recent decisions.

The background to the three cases

1. **The background – Re Ralls Builders Limited (In Liquidation) [2016] EWHC 243**
   Ralls Builders was a company which had made trading losses in the financial year to 31 October 2009. It suffered from business closure due to a harsh winter in the early part of 2010, and then from a financial loss due to defective works undertaken by a sub-contractor. By June 2010, when its accounts for 2009 were produced, it was apparent that the company was in financial trouble and faced severe creditor pressure. It was placed into administration on 31 October 2010. The liquidators contended that the directors knew or ought to have realised by 31 July 2010 that the company had no reasonable prospect of avoiding liquidation and should have ceased trading at that point. Accordingly, they applied for an order that the directors contribute to the assets of the company to compensate creditors under Section 214 of the Insolvency Act 1986 (**IA 1986**).

2. **The background – Stephen Dawson v Laura Bell [2016] EWCA Civ 96**
   This was an appeal by a company director (**SD**) against his fellow director (**LB**). SD and LB were in a personal relationship also, and after the breakdown of the same, SD transferred his shares in the company to LB for £47,500 in accordance with the transfer provisions of the company's articles of association. SD then ceased to be a director of the company. After signing the share sale agreement, LB failed to make payments to SD on the basis that SD had overpaid himself dividends in the sum of £54,000. When SD issued proceedings, LB counterclaimed, alleging SD had misappropriated company funds, which LB sought to recover as assignee of the company. SD in turn counterclaimed that LB was liable under the Civil Liability (Contribution) Act 1978 on the basis that she had been aware of the misappropriation of company funds and accordingly owed a duty to the company to prevent them. LB succeeded in her claim and SD's claims were dismissed. SD appealed.

3. **The background – (1) Haysport Properties Limited (2) Twinsectra Limited v Joseph Ackerman [2016] EWHC 393**
   Haysport Properties Limited and Twinsectra Limited were two companies in the same group, which handled charitable monies, run by the same director (**JA**). After he ceased to be a director, both companies brought proceedings against JA for causing them during the course of 2005 to make a £4 million loan from Haysport's assets to a third company (**C3**) and (in both companies' cases) grant security over their properties to secure a loan made to C3 to acquire a property. C3 was outside the group, but was effectively run by JA, albeit not as a director. After JA was removed as director of the claimant companies in 2011, the companies brought claims against JA for misfeasance, in that he had risked charity monies for his own benefit, without the claimants receiving independent advice or even being made aware of his interest in C3. They argued that the six year limitation period on their claims should not apply, given his dishonesty or deliberate breach of duty.

What did the courts decide?

In *Ralls Builders*, the High Court refused a wrongful trading contribution order. Although it was satisfied that by 31 July 2010 the company was insolvent on both a balance sheet and cashflow basis – and that the directors knew of the scale of the problem – it did not follow that insolvent liquidation was inevitable. The real question was at what point a deal with a potential investor was no longer achievable. The directors had relied on professional advice to the effect that they were not trading wrongfully, and they had acted reasonably in relying on it. Although a realistic assessment would have shown that by 31 August 2010 liquidation could not be avoided, the court had to determine whether trading beyond that point had caused loss to the company or worsen its creditors' position. It was conceivable that continued trading had not done so, and so the directors should not be liable to contribute.

In *Dawson v Bell*, the Court of Appeal found against SD. Under the contribution element, it was not just and equitable under Section 2(1) of the 1978 Act for LB to contribute to SD's share of what was owed to the company, even though she knew of the misappropriation of company money. Equitable principles did not require her to contribute for monies received solely for SD's benefit.

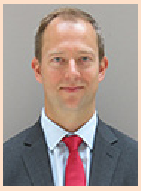
In *Haysport and Twinsectra v Ackerman*, the High Court found in favour of the claimant companies. The transactions complained of were outside the ordinary course of their activities, and put them far down the pecking order behind the secured lender to C3 (no security was taken by the claimants against C3). JA was hopelessly conflicted, could not claim to have given impartial advice to the claimants and could not point to previous successful property dealings, given the vastly different nature of the transaction which C3 had entered into. As the loans and security given by the claimants were to a party controlled by JA, they fell within Section 21(1)(b) (recovery of trust property) of the Limitation Act 1980, and the limitation period would be disapplied, although as JA believed his actions were in the claimaints' interests, Section 21(1)(a) (fraud) did not apply. However, as JA was under a duty to disclose his breaches of duty to the claimants and had not done so, Section 32(1)(b) and 32(2) of the Act (deliberate concealment and deliberate breach of duty) also applied, and the limitation period was accordingly disregarded.

What does this mean for practitioners?

As can be seen, a variety of factors can lead to vastly different results in litigation against directors. Reliance on independent professional advice, honest belief in the benefits of a course of action (or lack thereof), receipt of a benefit from a course of action and dishonesty and concealment are all factors which can make or break a cause of action. When considering such actions, a thorough and detached review of the merits of the case should be undertaken before commencing proceedings.

Contact

For further information on this subject please contact:



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BRM1074 04 16