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'Friends and benefits': an overview of the apportionment of contribution between directors guilty of misfeasance

KEY POINTS

- Directors have a collective responsibility when it comes to a company's affairs.
- This could nonetheless render them severally liable to the company when it comes to an account of profits or a wrongful trading claim.
- However, where they are joint and severally liable, they must have recourse to contribution claims against each other to determine who will ultimately bear the loss.
- If a fiduciary or knowing recipient has retained misappropriated assets, then these must be repaid to the company before any apportionment can take place.
- The apportionment of contribution will then otherwise generally follow the extent to which each director benefitted from the wrongdoing.
- In other cases, those directors who brought about the circumstances in which the breach occurred could be asked to bear most, if not all, of the loss.

INTRODUCTION

It is a fundamental principle that each director of a company has a shared responsibility for its management. Each must inform himself of the company's affairs and join with the others in supervising and controlling them. Even if a director has not actively taken part in a breach of duty, he will have failed in his responsibility if he ought to have known of the breach and failed to stop it. Of course, the extent to which he ought to have intervened will depend on the circumstances, including the role each director played in the company.

Generally, directors will be joint and severally liable for a breach of this collective responsibility. There are, however, circumstances in which the consequences for each director will not necessarily be the same. One example would be where an account of profits is sought as a result of directors misapplying the company's assets or opportunities. Whilst each director may have been involved, they will only be liable to the company for the profits each made personally. This is unless they are liable on an accessory basis for 'knowing receipt' or for 'dishonest assistance'.

Another example would be wrongful trading claims under s 214 of the Insolvency Act 1986 which might arise from misfeasance. If the court finds a number of directors liable, it must assess what contribution ought to be made by each of them separately: *Re Continental Assurance (No 4)* [2007] 2 BCLC 287. Joint and several liability will only be imposed upon the positive exercise of the court's discretion, having first examined the responsibility of each individual. There must also be some nexus between the director's conduct and the loss the company suffered.

In other cases, directors must resort to claims for contribution under the Civil Liability (Contribution) Act 1978 (CLCA 1978) if they wish to mitigate the extent to which they ultimately will bear liability.

CIVIL LIABILITY (CONTRIBUTION) ACT 1978

The right to contribution depends upon there being a commonality, even a partial one, between the 'loss, damage or harm' for which each co-director is liable to the company: *Royal Brompton NHS Trust v Hammond* [2002] UKHL 14, [2002] 1 WLR 1397. Once this is established, s 2(1) of the CLCA 1978 provides that:

> '[T]he amount of the contribution recoverable from any person shall be such as may be found by the court to be just and equitable having regard to the extent of that person's responsibility for the damage in question.'

Clearly this leaves a wide degree of discretion to the court to decide what would be fair to order. However, there are some indications as to how that discretion might be exercised. As a matter of general principle:

- the causative effect of each wrongdoer's conduct is taken into account, quite apart from the degree of fault;
- only those defendants before the court will be counted in the exercise of apportionment;
- apportionment will be made amongst the solvent defendants;
- the degree to which each defendant benefitted from the breach of duty is a key factor. If a fiduciary or knowing recipient has retained any money received in breach of trust, then it must be repaid to the victim before any apportionment can take place: *Dubai Aluminium Co Ltd v Salaam* [2003] 1 All ER 97. It is just and equitable for the loss to be satisfied out of retained profits prior to the liability for the rest being shared between the wrongdoers.

It goes without saying that the manner by which each co-director breached their obligations does not need to be the same. They need only be liable for the 'same damage'; for instance, one director may have breached his duty by misappropriating the

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company's assets whereas the other may have breached her duty by failing to put a stop to it. When it comes to the question of contribution between each of them, the starting point is that they have both caused the loss. This is the case even where the 'passive' director was the finance director and ought to have stepped in. In a small company where both directors jointly manage the company's affairs, and have equal access to its funds, they are equally responsible for safeguarding the assets even if one of them does not carry out the 'finance' role: *Burkett-Coltman v Hooke* [2011] All ER (D) 173 (Jul).

There may be scope to depart from this principle in some circumstances. In larger companies, for example, despite all of the directors having responsibilities with respect to the adoption of the company's financial statements, non-executive directors are entitled to rely upon the finance director for guidance on technical aspects: *Re Continental Assurance Co of London plc (in liq)* [2007] 2 BCLC 287.

However, the relative causative responsibility is only one factor in determining what ought to be the level of contribution. Indeed, it is unlikely to be just and equitable for a director to contribute anything at all if he derived no benefit from a misappropriation: *Dawson v Bell* [2016] EWCA Civ 96. Whereas if each director benefitted to some extent then an allocation may be made according to their proportional benefit: *Queensway Systems Ltd and others v Walker* [2006] EWHC 2496 (Ch), [2007] 2 BCLC 577.

The approach to apportionment by reference to benefit is consistent with the old equitable rule that a director may not claim contribution from his co-directors where he has had the sole benefit of the breach of trust: *Walsh v Bardsley* (1931) 47 TLR 564. This is no doubt fair in the usual run of cases.

However, this will not necessarily align with the *extent of responsibility*. In that sense it departs from the wording of s 2(1) of the CLCA 1978. Indeed, in *Charter plc v City Index Ltd* [2007] EWCA Civ 1382 the Court of Appeal warned against restricting the wide discretion conferred by the Act. In that case, the Court of Appeal overturned a first instance decision summarily dismissing a claim for contribution by a defendant who was liable in knowing receipt to a defrauded company. A manager of the company had deposited the misappropriated funds with the defendant in order to finance his spread betting transactions. The defendant settled with the company for £5.5m and then claimed contribution against the allegedly negligent directors and auditors of the company for allowing the fraud to go undetected. The defendant's profit from the fraudster's spread-betting account was £3m. It was accepted that this ought to have been returned before any contribution claim. Therefore, the dispute was over the balance of £2.5m which the defendant had paid from its own funds under the settlement. Apart from the £3m profit, it had not retained the rest of the misappropriated funds.

The judge at first instance held that, given the defendant's knowledge, it could not be just and equitable for it to receive contribution regardless of whether it had retained the funds or paid them away for its own purposes; the cause of the loss was the defendant's failure to repay all of the funds to the company. However, the Court of Appeal held that there was no presumption that this was the case. The apportionment of contribution should take place on the basis of the facts at trial. The Court of Appeal accepted that if the money had been retained then it had to be returned by the knowing recipient. This was a matter of 'obvious equity'. However, if the money had been paid away there was no automatic presumption that the knowing recipient had to be treated as if he had not done so. It depends on the facts.

Outside of misappropriation cases, a director may be relieved from an obligation to contribute even though the wrongdoing suited his interests. In *Murray Vernon Holdings Ltd v Norman Hassall* [2010] EWHC 7 (Ch), this happened where the directors' liability arose from the giving of unlawful financial assistance by the company when it bought out the shareholding of two of its directors. The other directors insisted, unilaterally, that the shares be paid for by way of a lump sum, rather than instalments. This necessitated a transfer of funds which constituted the unlawful financial assistance. The central role those two directors played in bringing about that course of events rendered them fully responsible, even though the 'selling' directors had benefitted from the transaction. However such matters are fact sensitive and, in this case, the company had ultimately not suffered any loss.

CONCLUSION

It is interesting to contrast these approaches with that taken when it comes to the relative liability of co-trustees. They are often said to be in a somewhat analogous position to that of co-directors. Yet, it has also been said that the court would be slow to order that a trustee who actively breached his duties must pay contribution to a co-trustee who was only passively in breach – it would discourage trustees from playing an active part in administering their trusts: *Lewin on Trusts (19th ed)*, para 39-085.

Obviously such a policy consideration would find little sympathy in the company sphere. The usual approach with respect to directors is much more straightforward: those directors who benefit from their wrongdoing, or play a role in bringing it about, will have to share the liability. ■

With reference to Halsbury Laws of England, Damages (Vol 29 (2014))

Further reading

- LexisPSL Restructuring and Insolvency: Practice note: Directors and insolvency – role, powers and duties
- LexisPSL Restructuring and Insolvency: Practice note: Directors' guide to dealing with a company in financial difficulty
- RANDI Blog: Directors' duties and assessing insolvency, 18 November 2013