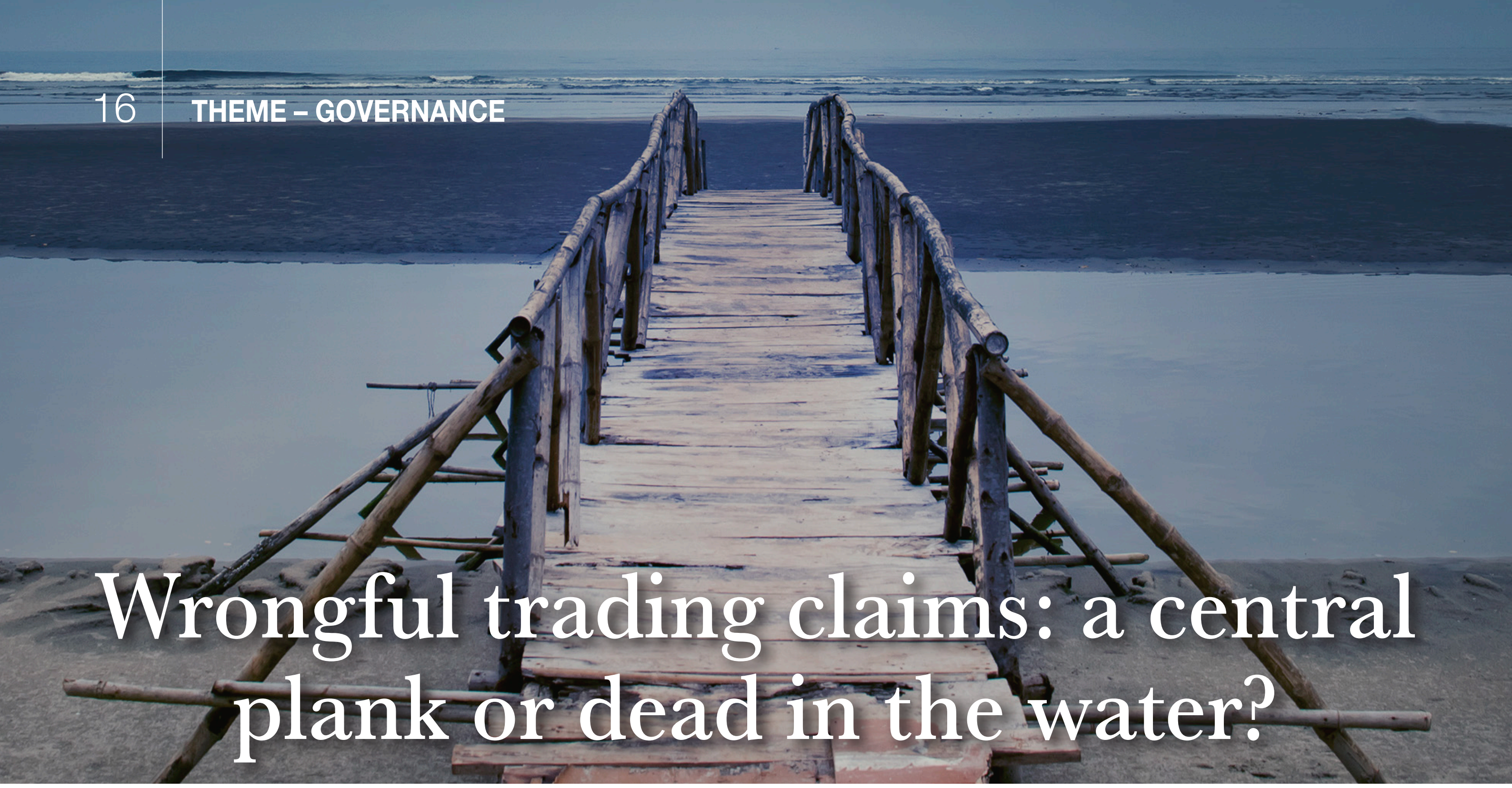


Wrongful trading claims: a central plank or dead in the water?

Section 214 has been described as a 'central plank' in creditor protection laws. But those using it to sue directors should tread carefully, say **James Morgan KC** and **Lauren Kreamer**

In the long-awaited Supreme Court judgment in *BTI 2014 LLC v. Sequana SA* [2022] UKSC 25, at [123], Lord Reed described section 214 of the Insolvency Act 1986 as "a central plank in the statutory scheme of creditor protection" and noted it is to that statutory scheme "which purely judge-made rules or principles must either be accommodated or abandoned". Further, at [238], Lord Hodge suggested that it would only be in "rare circumstances" that the court would need to consider how far section 214 constrained the development of the common law to provide a remedy in circumstances outside those identified in that provision.

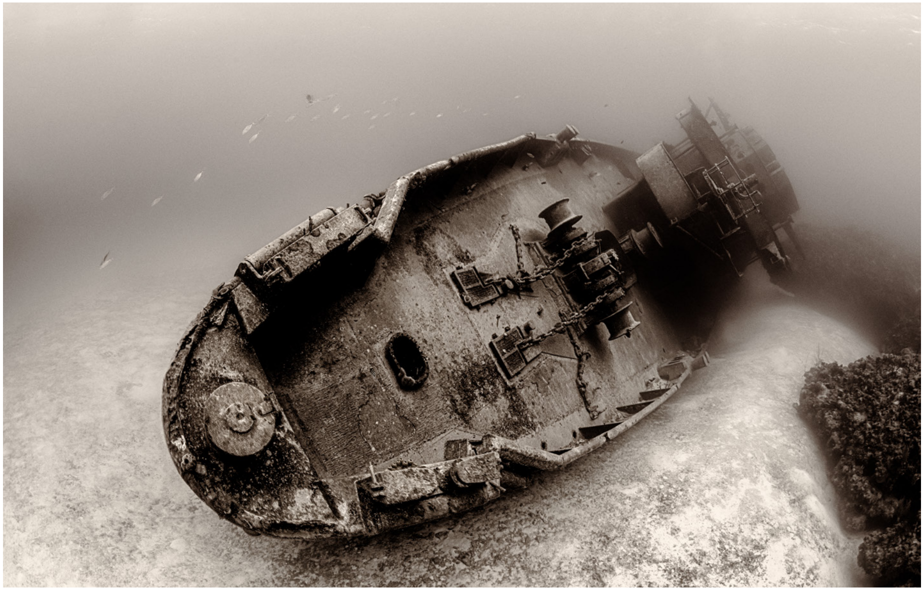
Expensive and unattractive

While it may be that section 214 is a key part of the overall formal structure of insolvency law, in practice, as a result of unfavourable case law and statutory intervention, wrongful trading claims have become expensive and unattractive options for office-holders (or their assignees) to pursue.

As *Re Ralls Builders Ltd* [2016] EWHC 243 (Ch) underlined, if the company cannot be shown to have suffered loss caused by the directors' decision to continue to trade, and that decision cannot be shown to have worsened the position of the creditors as a whole, a contribution under section 214 will not be ordered. That is so even where the company's financial situation was such that the directors should have concluded that insolvent liquidation was inevitable. And even if the continued trading worsened the position of some of those creditors, the general rule is that an increase in the overall net deficiency must be causally linked to the continuing trading.

Further, in a very significant change to insolvency law, the Corporate Insolvency and Governance Act 2020 (CIGA) and the regulations extending its ambit suspended liability for wrongful trading for a significant part of the Covid-19 pandemic. The effect of those provisions is that directors will be assumed not to have been responsible for any worsening of the financial position of a company or its creditors in the periods from 1 March 2020 to 30 September 2020 and/or from 26 November 2020 to 30 June 2021.

For many office-holders currently contemplating bringing proceedings in relation to the period of the pandemic, the CIGA provisions will be an effective bar to any attempt to pursue a director for wrongful trading. There is no need to consider any of the intricacies of the section 214 provisions and their application; CIGA effectively closes the door to any wrongful trading claims in respect of the (almost) 16-month period to which they apply. While technically possible, it would be a brave applicant indeed who attempted to show that the company's net deficiency had worsened during the eight-week lacuna, such that they could maintain a claim in respect of the period not covered by the statutory assumption. The wait for such a case goes on. Further, even if a claim can be made in respect of a period after 30 June 2021, it may be that the resultant increase in net deficiency is insufficiently large



to make its pursuit a sensible commercial proposition.

Difficulties in bringing claims

The difficulties in bringing a wrongful trading claim against a prolonged and complicated factual background are illustrated by the recent decision of the High Court in Chandler v. Wright [2022] EWHC 2205 (Ch). In that case, section 212 and 214 claims were brought against the former directors of BHS group companies on the footing that the relevant date of knowledge was either "by 17 April 2015" or "some later date prior to 25 April 2016", with Part 18 responses identifying five intermediate dates. The claim pleaded only the increase in net deficiency between the two identified dates, a little over a year apart.

Section 214, Insolvency Act 1986: summary

The wrongful trading provisions apply where:

- The company has gone into insolvent liquidation (section 214(2)(a));
- At some point before the commencement of the winding up, a director of the company knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or entering insolvent administration (section 214(2)(b)).

If those conditions are satisfied:

- The court may declare that the director is liable to make such contribution (if any) to the company's assets as the court thinks proper (section 214(1)); but
- The court shall not make such a declaration with respect to the director if it is satisfied that, after he knew or ought to have concluded as above, he took every step with a view to minimising the potential loss to the company's creditors as he ought to have taken (section 214(3)).

For the purposes of section 214(2) & (3), the facts which a director ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and
- The general knowledge, skill and experience that that director has (section 214(4)).

> **"The decision should nevertheless serve as a… reminder that the date of knowledge must be pleaded with great care and in reliance upon a forensic analysis of the company's losses"**

On appeal from the dismissal at first instance of the directors' application to strike out parts of the claim, Edwin Johnson J held that, when it comes to pleading wrongful trading claims, applicants cannot simply leave the relevant date of knowledge open. While it is permissible to plead alternative dates in wrongful trading claims, the pleading must include a specified date or range of dates, coupled with proper pleas as to causation and loss at each date. The fact that the period of 12 months was "at large" was deemed by the court unfair to respondents who needed to be able to respond to the claims against them.

Cautionary tale

In practical terms, the decision was not, in fact, fatal in that case; the applicant was given the opportunity to consider amending its claim. The decision should nevertheless serve as a cautionary tale to those considering bringing wrongful trading claims, and a reminder that the date of knowledge must be pleaded with great care and in reliance upon a forensic analysis of the company's losses. That analysis must not only show that the losses are connected to the date of knowledge relied upon (as the date when the director knew, or should have known, that insolvency was inevitable), but will also need to prove to the court that the losses were caused by the decision to continue trading, as opposed to the final decision to cease trading.

Returning to *BTI v. Sequana*, the judgment of Lord Reed at [93]-[99] provides something of a refresher on the ambit of section 214, and the differences between it and the common law duty to have regard to the interests of creditors of companies in or bordering insolvency. Reading that summary against the background of the matters set out above, it is not difficult to conclude that, in many cases, breach of fiduciary duty claims will be an easier option than wrongful trading claims.

BTI v. Sequana confirms the common law duty to have regard to the interests of creditors arises at an earlier point in time than when section 214 is engaged. The former duty arises when the company is insolvent or is bordering on insolvency or an insolvent liquidation/administration is probable. The latter is engaged when a reasonably diligent and competent director would know that there was no reasonable prospect of avoiding insolvent liquidation/administration or, put another way, when such insolvency proceedings are inevitable. Further, the remedies are far narrower under section 214, and proceedings can only be brought after the commencement of a formal insolvency process in respect of the company.

Lighthouse in the fog

Lest the recent authorities and legislative schemes give the impression that wrongful trading claims are now practically impossible, *Biscoe v. Milner* [2021] EWHC 763 (Ch) is something of a lighthouse in the fog. The applicant liquidators in that case brought a wrongful trading claim, alongside claims for dishonest assistance and/or knowing receipt, conspiracy, transactions at an undervalue, breach of directors' duties and fraudulent trading, in the context of an investment scheme which had been fraudulent from its inception. The High Court held that one director was indeed liable for wrongful trading, emphasising that there is no requirement in a wrongful trading claim to show that the loss would not have been suffered if the director had complied with his duties, but instead – applying *Re Ralls Builders* – that there was a causative link between the increase in the net deficiency to creditors and the continuation of trading.

Taking the CIGA provisions alongside the existing difficulties in pursuing wrongful trading claims, and the reminder in *Chandler v. Wright* of the importance of a forensic approach to pleading causation and loss, it is easy to see why the big drivers of insolvency cases, namely the litigation funders, are unlikely to be keen on pursuing wrongful trading claims. Indeed, it is difficult to see anything more than a handful of wrongful trading claims being pursued in the coming years.

It may be that wrongful trading claims are not quite dead in the water, but those considering walking this particular 'central plank' would be well-advised to tread very carefully.

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