CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

Analysis

Misfeasance Trading and the £150 million Directors' Fine

Nick Hood

Nick Hood
Senior Business Advisor
Opus Business Advisory Group

Biography

Nick Hood is the Senior Business Adviser at the Opus Business Advisory Group (https://www.opusllp.com), the largest independent advisory, restructuring and insolvency firm in the UK.

Nick was a licensed Insolvency Practitioner, working in the business rescue market for 25 years. He is a committed internationalist, having created the largest global network of independent business rescue firms and having also worked overseas in Canada, Milan and Bahrain.

In his earlier career and after qualifying as a Chartered Accountant in 1970, Nick held senior executive positions in major companies in the construction, engineering and media sectors, as well as working for a boutique investment bank.

Nick's thought leadership and opinion blogs for Opus can be found at https://opusllp.com/resources/.

Keywords Misfeasance, Fiduciary duty, Insolvency, Wrongful trading, Directors, Professional advice, Administration, Companies Act 2006, Disqualification
Paper type Opinion

Abstract

A high profile recent case has created a new offence that directors can be accused of committing – Misfeasance Trading – and one that is easier to prove than the more familiar Wrongful Trading. In this article, the author looks at the circumstances of the case and the lessons to be learnt by all directors if they are to protect themselves against such claims – which in this instance resulted in a firm's directors being ordered to pay some £150 million.

Introduction

It's not every day that the Directors of a failed company find themselves on the wrong end of fines totaling £150 million, but that was the fate of the former directors of British Homes Store (BHS), the major UK retailer which collapsed into Administration in 2016 just 15 months after it had been sold to a consortium with extremely limited retail experience by its previous owners (Philip Green and his family).

The BHS judgment confirming the huge liability came two months after the directors had originally been found guilty not only of the widely known offence of Wrongful Trading, but also of 'Misfeasance Trading', a new legal concept in an insolvency

CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

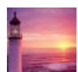
context and an offence tested in this instance for the first time under English law. It is based on a breach of directors' duties not under the insolvency legislation, but the Companies Act 2006 instead. The implications for directors running struggling companies are considerable, significantly ratcheting up their level of risk.

What is 'Misfeasance Trading'?

The Judge in the BHS case (re Wright *v* Chappell) ruled that the directors had continued to trade when the company should have gone into Administration or insolvent Liquidation much earlier if they had complied with their fiduciary duties.

The major concern among directors and their professional advisers as a company approaches and then becomes insolvent is usually Wrongful Trading under Section 214 of the Insolvency Act 1986. However, insolvency practitioners have always struggled with the high burden of proof in persuading the Court that the directors knew (or ought to have known) that an insolvent liquidation was unavoidable. We have previously looked in detail at the issues in securing successful Wrongful Trading claims and what directors can do to avoid this fate[1].

By contrast, the risk of committing Misfeasance Trading occurs much earlier in a company's decline than this, which in theory makes it much easier to establish.



CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

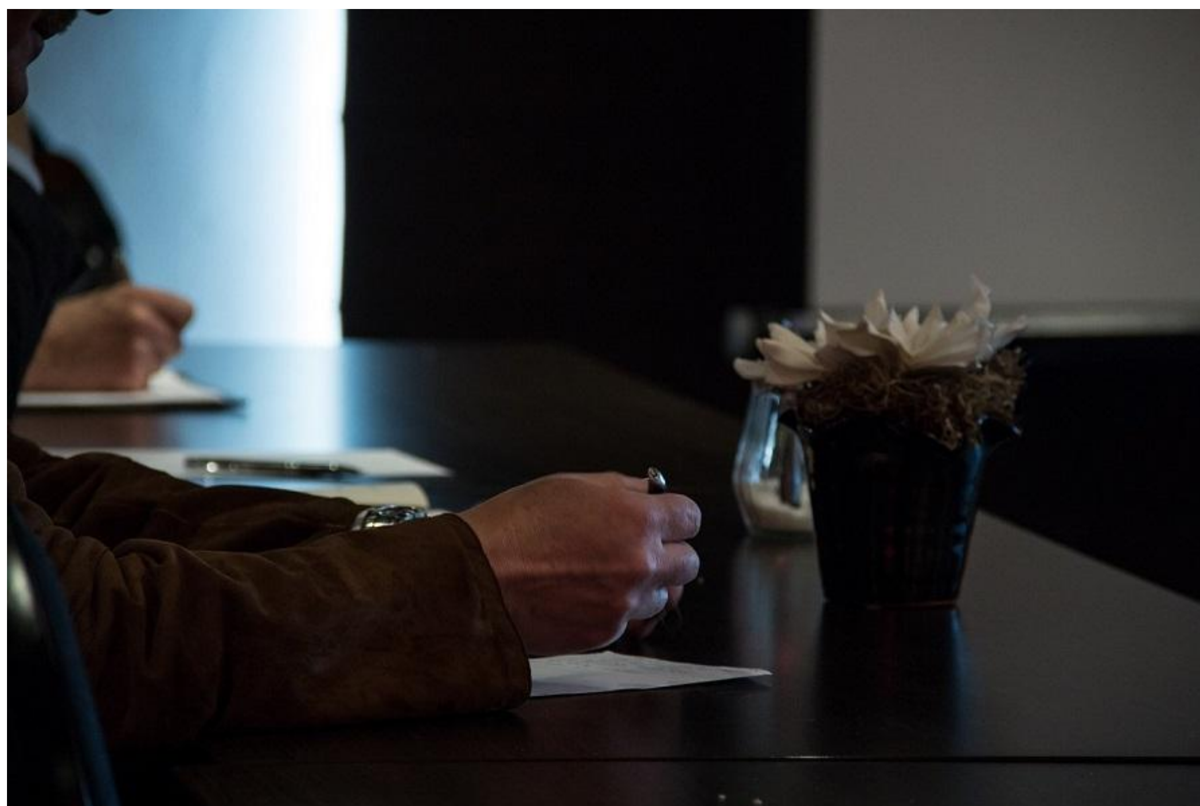
The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

In the BHS case, the directors were found to have breached a number of duties imposed on them under the Companies Act 2006, including the:

- duty to act within their powers (s171(b)),
- duty to have regard to the interests of creditors (s172(3)),
- duty to exercise reasonable care, skill and diligence (s174),
- duty to avoid unauthorized conflicts (s175), and
- duty not to accept benefits (s176).

The judgment on whether a director has breached these duties will always be based on their specific actions or inactions. This means that the particular facts of each case will determine the outcome of claims for breach of duty.

Despite this, there are some clear takeaways in the BHS case about what behaviour by directors can either expose them to prosecution for Misfeasance Trading, or else protect them against such claims.



Taking professional advice and taking it seriously

Before the BHS case, it was believed by most experts that by taking professional advice in the period preceding a formal insolvency, directors gave themselves a high level of protection against Wrongful Trading. This judgment makes it clear that merely getting advice is a long way short of what is actually required, focusing on

CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

how advisers are instructed, the timing of taking the advice and how it was dealt with:

- what information was given to the advisers?
- was the information accurate?
- was the information full and complete?
- was the advice taken before or after the event?
- was the advice given discussed by the Directors?
- was the advice followed and if not, why not?

In the BHS case, the directors failed to convince the Court that they had ticked all or indeed any of these boxes, despite having taken advice from credible professional firms with the relevant expertise.

The decision demonstrates that if directors pay no more than lip service to advice, seeking it just to tick a box, don't even consider or discuss it, or don't give their advisers the whole picture, then they will be seriously exposed to being found guilty of one or both of Wrongful and Misfeasance Trading.

Recording and documenting decisions

The BHS outcome also highlights how vital it is for directors to hold regular board meetings, to attend them either face-to-face or digitally, to take full minutes of their discussions and explain in them why particular decisions were taken. The BHS directors were held to have been in breach of their duty to exercise reasonable care, skill and diligence in fulfilling any of these duties. They were also found to be

CREDIT CONTROL JOURNAL and ASSET & RISK REVIEW is published by House of Words Media Limited.

The current issue and full text archive of this journal is available at **https://www.creditcontrol.co.uk/**

in breach of their duty to consider the interests of creditors. There was no evidence that they had done so at critical points in the evolution of the crisis engulfing the company.

The Judge noted that keeping minutes and other records is an "important discipline". The judgment also emphasized that standard form minutes that just state that directors had considered and concluded that they were acting in the best interests of creditors without a full statement of the detailed discussions and reasons for believing that they were, would be seen by the Court as inadequate fully to fulfil this duty to creditors.

Instead, the Judge commented that in making decisions, directors should apply "rational" thought, provide "justification", have an "honest belief", apply "commercial judgment" and act with "reasonableness" and in "good faith". They should not make decisions that are "irrational", with "blind optimism "or "wishful thinking" or ones that are "fanciful" or "overly optimistic".

Timing is key in opening the door to Misfeasance Trading prosecution

The Judge concluded that if the BHS directors had considered the interests of creditors and acted in good faith when they decided that it was in their interests to continue trading, the Misfeasance Trading claims would have failed. They were not able to satisfy the Court on this point.

There was a significant point regarding timing. The first occasion when the BHS directors were found to have breached their duty to consider the interests of creditors (for the purpose of the Misfeasance Trading claim) was some six months earlier than the date on which the claim against them for Wrongful Trading was established.

It's a sobering conclusion from this case that in some circumstances, directors could be found guilty of Misfeasance Trading but cleared of Wrongful Trading. This is because the potential breaches of Companies Act 2006 duties are significantly broader in scope, while the level of proof required for establishing guilt is far lower.

How large can damages be for Misfeasance Trading?

Two former BHS directors were found personally liable in the June decision to pay a total of £18 million in respect of Wrongful Trading, which turned out to be the least of their downside.

On the other claim for Misfeasance Trading, the Court found that where, as in the BHS case, the directors' breach of duty was entering into a transaction which allowed the company to continue to trade contrary to the interests of creditors, the starting point for the loss for which they would be liable is the increase in the net deficiency caused. This equates to the total difference between the company's assets and liabilities at the point of the breach and then at the commencement of BHS's Administration. In the BHS case, this difference was well north of £100 million.

The judgment held the BHS directors to be jointly and severally liable for the award, which should be a salutary lesson for individual directors to be mindful of the potential downside for them from the actions of their fellow directors. The circumstances of the BHS case were exceptional, as was the size of the deficiency the ultimate insolvency crystallized and the directors have been asked to meet, but even an award of a fraction of the BHS case would be a financial disaster for most other directors.

The consequences of Misfeasance Trading

The initial and most serious implication for directors arising from Misfeasance Trading is obviously the financial compensation order made against them. This could give rise to a personal insolvency and a genuine threat to their personal assets.

Being found guilty of Misfeasance Trading will likely also be taken into account in any disqualification proceedings against directors[2].

Disqualification exposes directors to the Compensation Order regime[3] introduced in 2015, under which creditors can request that The Insolvency Service takes action to obtain a Court Order for compensation against one or more directors, provided they have already been disqualified. However, any payments made under a Misfeasance Trading order by a director would be taken into account to avoid any double jeopardy over the same loss and the same behaviour.

The moral of the BHS Misfeasance Trading story

Once insolvency becomes probable (or imminent) the directors' fiduciary duty under s172 of the Companies Act 2006 to promote the success of the company is modified. Thereafter, they must give "adequate consideration" to the interests of

creditors. The relative weight given to those interests differs, dependent on where the Company is located on the 'business decline curve'. The further along it, the more the weight that should be given to their interests.

The "zone of insolvency" or "twilight zone" as this pre-insolvency filing period is often referred to is a tough time full of uncertainties and risk for directors. There is nothing straight forward about deciding how much weight should be attributed to the interests of the creditors and whether a decision is the right one in the face of likely insolvency.

What the BHS case confirms is that directors cannot escape liability simply just because they have gone through the motions of instructing professional advisors. Those advisors need to be properly briefed and be fully informed, while the directors need to heed their advice and properly document their decisions. Doing that remains one of the best ways that a director can demonstrate that they are discharging their duties and consequently minimize the risk of a subsequent claim against them if the company ultimately enters an insolvency process.

Reference

[1] (22 April 2024) *What is Wrongful Trading and how can I avoid it?* Opus Business Advisory Group. Available at: https://businessrescue.co.uk/what-is-wrongful-trading-and-how-can-i-avoid-it/

[2] (20 December 2021*) Avoiding Disqualification as a Director*. Opus Business Advisory Group. Available at: https://businessrescue.co.uk/avoiding-disqualification-as-a-director/

[3] (10 October 2023) *Compensation Orders – how can they affect Directors?* Opus Business Advisory Group. Available at: https://opusllp.com/blog/compensation-orders-how-can-they-affect-directors/