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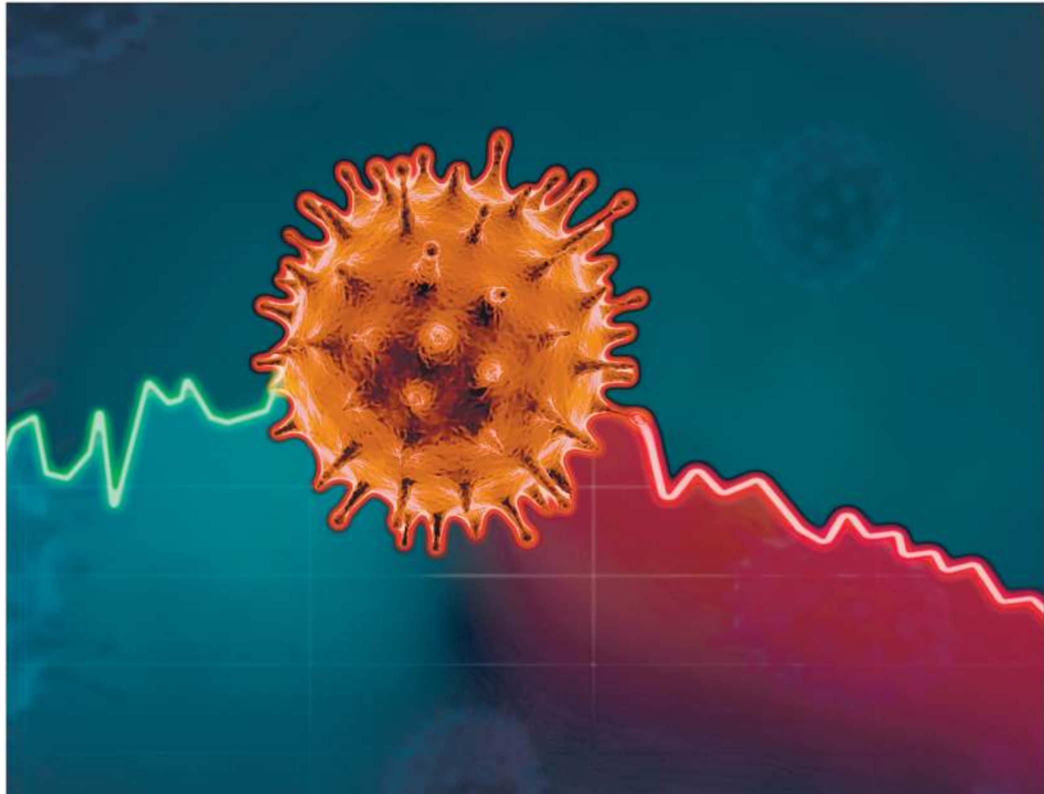
Wrongful trading – directors required to make contribution

Advocate Raymond Ashton offers his insight in this second article looking at the issues of trading through insolvency



Practising liquidators should be sympathetic to traders who have suffered unprecedented trading conditions over the last year and Guernsey should consider passing laws similar to those in England, says Advocate Raymond Ashton. (29335327)

GUERNSEY is gradually coming out of a second lockdown.

This article is a follow up to my previous one. Readers will recall that under Section 434 of the Companies Law 2008, if in the course of the winding up of a company it appears on the application to the liquidator that the directors are guilty of wrongful trading they can be required to make a contribution to the company's assets.

The next section will examine some of the cases in the area whilst the third section will look at what has to be established before a successful action can be brought whilst the final section will look at developments elsewhere.

The cases

Inevitably the cases are driven by a question of fact and degree. As such they are case specific but they do provide some guidance as to the factors which will be taken into account.

It should be borne in mind that often no action is taken because the liquidator has insufficient funds to pursue a claim or that very little will be recovered from the errant director.

In RE DKG Contractors Ltd (1990) BCC 903 a respondent director admitted he knew nothing about companies and had no real idea as to what being a director entailed.

Not surprisingly the judge held that this offered no defence. When a liquidator brings proceedings, he should specify a date when the respondents should have realised that an insolvent liquidation was inevitable.

In Re Sherborne Associates Ltd (1995) BCC 40 it was held that where the liquidator failed to make out his case on the date specified, he could not substitute some later date. The case of RE a Company (No 005009 of 1987) related to the role of the bank concerned a company's unsecured borrowing. A few months later, the company went into insolvent liquidation. A single transaction was clearly insufficient to give rise to an allegation that the bank could be treated as a shadow director, (a person in accordance with whose directions or instructions the directors are accustomed to act) words clearly implying an ongoing series of acts of supervision by the bank.

Accordingly, when the merits of the case were considered in Re MC Bacon Ltd (1990) BCC 78, allegations of wrongful trading by the bank were, in the words of Knox J, 'rightly abandoned by the applicant'.

Finally, as is the case with fraudulent trading, payments made to the liquidator go to increase the assets of the company. In Re Purpoint Ltd (1991) BCC 121, Vinelott J explained that the function of the legislation was to recoup the loss to the company in order to benefit the creditors as a whole.

Ingredients of a successful action

In order for a wrongful trading action to succeed two pieces of forensic evidence are necessary. It is necessary to establish a date on which the directors should have realised that the insolvent liquidation was inevitable and the liquidator has to prove the downturn in the company's fortunes from that date.

Unless a date can be established wrongful trading will not be made out. In Re Cubelock (2001)BCC 523 a company was formed where the directors projected a loss in the first year but in the second year there would be an upturn and the company would go into profit. No profit was ever made and the directors put the company into liquidation as soon as they realised that an insolvent liquidation was inevitable.

The allegation of wrongful trading was rejected by Park J who said that: what makes trading wrongful is not the bare fact of balance sheet insolvency, but the continuation of trading at a time when the directors either knew or on any realistic view ought to have known that there was no reasonable prospect that the company's creditors would ever get paid. These words are clearly apposite and not surprisingly were sounded by the former leader of the tax bar.

The Corporate Insolvency & Governance Act (CIGA) 2020

There have been some recent developments in the law in this area. CIGA 2020 includes some provisions which make only temporary changes to insolvency law in light of the coronavirus pandemic and its anticipated economic effects.

These are as follows: i) restrictions on the ability to present winding up petitions and to make winding up orders for a set period; ii) suspension of liability for wrongful trading during a specified period; iii) power to amend insolvency law to mitigate the effect of the coronavirus.

These provisions are something that might easily be included in the local law as a matter of priority.

> **'Many businesses through no fault of their own have incurred substantial losses. No doubt a substantial proportion will be hoping that the summer brings a bumper season'**

Conclusions

For the reasons stated in the opening paragraph, liability for wrongful trading is more of a threat than a reality. It is undoubtedly a weapon in the armoury of the liquidator but even in the Carlyle case locally it remains the case that there is no fully decided case on the subject in Guernsey.

One difficulty facing businesses in Guernsey and elsewhere at the moment is that we are just emerging from a second Covid wave. This is particularly true of the retail sector, particularly fashion, hospitality and no doubt other seasonal businesses. Many businesses through no fault of their own have incurred substantial losses. No doubt a substantial proportion will be hoping that the summer brings a bumper season.

Of course this is perfectly rational behaviour but the trader should still check his projections and make a record of them and the decisions he made.

In addition, in so far as he is able, he should try to cut back on his salary (which in any event may be a necessity) and in addition regularly review his projections, preferably in consultation with his legal and financial advisers.

Traders who are particularly vulnerable are those with high fixed costs such as rents, which would cover most of the High Street.

Finally a word for practising liquidators: they should be sympathetic to the traders who have suffered unprecedented trading conditions and Guernsey should consider passing laws similar to those in England and referred to above.

Such traders should see an advocate when in doubt about their solvency.