Wrongful trading claim not made out (Re Bright Future Software Ltd)

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Restructuring & Insolvency analysis: The court held that a director was not liable for wrongful trading. The Deputy Judge held that, on the evidence available, the claimant had been unable to demonstrate that the director knew or ought to have known that there was no real prospect the company could avoid insolvent liquidation. It was therefore unnecessary for the court to go on to consider whether there was any net deficiency in the company's assets in the amount of approximately £6.5m (as claimed) or £3m (as contended for by the director in the alternative).

The assignee's claim for a transaction at undervalue/breach of duty in the amount of £325,000 also failed. The preference claim for £188,769 was, however, successful. Written by Samuel Parsons, barrister, at Guildhall Chambers.

Re Bright Future Software Ltd (Manolete Partners Plc v Ellis) [2020] EWHC 1674 (Ch)

What are the practical implications of this case?

Re Bright Future Software is an illustration of the difficulties in making out a wrongful trading claim under section 214 (or 246ZB) of the Insolvency Act 1986 (IA 1986). It is the latest in a line of first instance authorities that show the strictness of meeting the key tests that (i) the respondent knew or ought to have known that the company had passed 'the point of no return'; (ii) that knowledge existed at a particular point in time; (iii) the need to plead that exact point in time; and (iv) the need to show a net deficiency of assets.

The decision also demonstrates the need for claimants to pin their colours to the mast in terms of identifying a specific date of when there was no reasonable prospect of the company avoiding insolvent liquidation. The risk to the claimant in this requirement is that the claim is dependent on factors that may not be apparent to office-holders or (as in this case) assignees. Those risks can to some extent be mitigated by early interview of the relevant people involved (see para [15]), or by pleading a breach of duty in tandem where possible (see para [211]).

Readers should also bear in mind that sections 12 and 13 of the Corporate Insolvency and Governance Act 2020 (peculiarly headed 'suspension of liability for wrongful trading') will make such claims increasingly difficult in the near future. Subject to certain exceptions, the courts will 'assume' that respondents are not responsible for the worsening of a company's financial position between 1 March 2020 and 30 September 2020.

What was the background?

The company in liquidation (BFS) was part of a scheme to provide apprenticeships and jobs in the North West of England. BFS was incorporated in 2012. It was funded partly by a loan from the respondent (Mr Ellis), and partly by a government-backed grant. BFS went into creditors' voluntary liquidation in February 2016.

By far the largest of the three claims brought by Manolete (as assignee of the claims of the liquidators and BFS) was for wrongful trading. The principal allegation was that Mr Ellis, as (non-executive) director of BFS knew or ought to have known by January 2015 that there was no reasonable prospect that BFS could avoid going into insolvent liquidation. The calculation of the net deficiency alleged to have been caused was approximately £6.5m, although the issue arose after cross-examination of the liquidator as to whether that had been reduced to £3m.

The key documents relied on were (i) a query raised with BFS' Hurst & Co in February 2014 that suggested BFS could be trading while insolvent; and (ii) an email in December 2015 from an employee of KPMG stating that it was essentially a matter for the directors as to whether BFS should continue to trade. The key part of Mr Ellis' own evidence (at para [129]) was that nobody suggested at the relevant time that it was appropriate to 'throw in the towel'.

Claims were also brought for the transfers of £325,000 and £188,769, on the bases of, variously, IA 1986, ss 238 and 239, and for misfeasance (ie what would have been under IA 1986, s 212, had the claims been brought by the liquidators rather than the assignee).

What did the court decide?

The wrongful trading claim essentially fell at the first hurdle. The Deputy Judge held that, as of 31 January 2015 (Manolete's pleaded date: para [339]), the test under IA 1986, s 214(2)(b) was not met. Notwithstanding all of the submissions made by Manolete that indicated BFS was facing financial difficulties at the time, it was not possible to conclude (and nobody appears to have concluded at the time) that there was 'no reasonable prospect that the company would avoid going into insolvent liquidation'. The Deputy Judge held (at para [354]) that it would have been 'very harsh' for Mr Ellis to be found liable on the facts of this case, particularly given the advice that was given by KPMG on 18 December 2015: (para [355]).

Only the preference claim for £188,769 succeeded. The claim for £325,000 failed on the basis that BFS acquired consideration in that same amount, essentially on the basis it was the repayment of a loan previously advanced by Mr Ellis: (para [235]). Despite Manolete's arguments to the contrary, primarily on the basis of a later loan facility agreement, the transfer was held not to be a transaction at undervalue: (paras [268], [271]). Neither was it a breach of duty; the payment caused no loss, nor was it improper: (para [291]).

Case details

- Court: High Court, Chancery Division
- Judge: Richard Spearman QC (sitting as a deputy judge of the Chancery Division)
- Date of judgment: 26 June 2020

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