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Re Ralls Builders Ltd - directors not liable to contribute to costs of bringing wrongful trading application

Technical Bulletin No: 710

Case: Re Ralls Builders Ltd (in liq); Grant v Ralls [2016] EWHC 1812 (Ch), Snowden J, 20 July 2016

Synopsis: In a follow-up judgment to the wrongful trading case of *Re Ralls Builders Ltd* (in which Snowden J held that the directors were not liable to make a contribution to the company for wrongful trading), the court confirmed that the directors were also not liable to contribute towards costs and expenses of the liquidation. Further, as the directors did not have to make any contribution to the company, the court could not make a disqualification order under s10 CDDA 1986.

Topics covered: s 214 Insolvency Act 2016; Wrongful Trading; Disqualification

The Facts

In *Re Ralls Builders Ltd (in liq); Grant v Ralls* [2016] EWHC 243 (Ch)) (technical bulletin 680) (the "February Judgment"), the liquidators brought wrongful trading proceedings against the directors under s 214 of the IA 1986 for a contribution of around £1 million to the company's assets.

In the February Judgment, Snowden J held that the directors should have realised earlier that the company had no reasonable prospect of avoiding insolvent liquidation or administration. Given that the company had paid back its bank creditor but allowed new trade debt to be incurred which was not repaid, the directors could not rely on the "every step" defence. However, even though the directors had wrongfully traded, the court did not make a contribution order because it was not clear that the wrongful trading had increased the company's net deficiency

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The Decision

In the February Judgment, Snowden J left open two issues which have now been addressed. The first was whether the directors should contribute to the company for the ancillary costs and expenses of the administration and liquidation, to the extent unnecessarily increased by the wrongful trading. The second issue was whether the court should disqualify the directors from acting as directors under s10 CDDA.

Contribution to costs of the insolvency

Snowden J concluded that it would be illogical to order the directors to pay costs which the liquidators had incurred in trying to prove – unsuccessfully – that loss had been sustained. Although there was a period of wrongful trading, the directors' conduct was not wrongful per se and they were not being punished as the company had suffered no loss. While wrongful trading claims are not tortious, like tortious claims, they aim to provide a remedy

for loss and are often brought alongside claims in tort. This similarity allowed the court to hold that s 214 claims should be governed by the principle that expenses incurred in investigating and bringing a claim are not generally recoverable as damages.

Another factor against a contribution order was the decision in *SISU Capital Fund v Tucker* [2006] BCC 463, which held that insolvency officeholders cannot recover the costs of their own time spent in assisting in litigation unless they come within the so-called “Nossen Principle”. The Nossen Principle provides that a company may be able to recover the direct costs of its own specialist employees if they are the most suitable experts to use in a matter requiring expert evidence. In *Ralls Builders* the principle was not applicable because litigation is not an area of expertise intrinsic to the liquidator’s profession and no special rules applied to insolvency cases. The court noted that both sides had also used expert witnesses.

Disqualification

As Snowden J did not make an order for the directors to contribute to the company, he concluded that the court had no jurisdiction to make a disqualification order under s10 CDDA. The legislation requires the court to have made a contribution order and not simply to have found that the directors continued to trade beyond the point at which they knew or ought to have known that the company had no reasonable prospect of avoiding insolvent liquidation/administration.

Comment

The judge’s view on costs sits comfortably with his reasoning in the February Judgment. As the directors were not liable to make a personal contribution to the company, it follows that the directors should not be required to contribute to the cost of bringing an unsuccessful s 214 claim.

The case offers further analysis of s 214 in paragraphs 31-34 of the judgment. In particular, it was said that the causation for wrongful trading requires something more than "a but for test", and that a director's conduct is not wrongful simply because there was a relevant date when he ought to have concluded that insolvent liquidation was inevitable. Even if directors continue to trade beyond this point, unless the company’s net deficiency increased because of the continued trading, directors will not have to contribute to the company under s 214.

In addition, the judge did not consider that it was wrongful per se if a director does not instigate insolvency proceedings, as it is clear that this is not a requirement of s 214, and they will also not be liable to contribute towards any increased insolvency costs. This will provide some comfort to directors.

Furthermore, if no contribution is ordered, then the directors have the additional comfort that the wrongful trading cannot give rise to a s10 CDDA disqualification order (although other grounds for disqualification may arise in the particular circumstances of a case). This may seem a little surprising, but arises from the legislation requiring a contribution to be ordered.

Conversely, liquidators and administrators considering a s 214 claim must be careful to

test if there has been an increased net deficiency. They may succeed in proving wrongful trading, but still fail to benefit the estate if there has been no such increase. Indeed, in that situation, the estate will have suffered from incurring additional costs.

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