Briefing

Corporate Turnaround and Insolvency

Wrongful trading and the defence of taking every step to minimise the potential loss to creditors as a whole

The recent decision in *Brooks and Willetts (Joint Liquidators of Robin Hood Centre plc) v Armstrong and Walker [2015] EWHC 2289* sets out guidance on the burden of proof for directors in wrongful trading claims when seeking to establish that they have taken every step to minimise the potential loss to creditors. We explore the issues raised for practitioners.

The background to the case

This case considered the defence (under section 214(3) of the Insolvency Act 1986) available to directors of taking "every step to minimise the potential loss to creditors" once a liquidator has established the threshold test for wrongful trading (i.e. that there was no reasonable prospect that a company would avoid insolvent liquidation).

In this case, a company which ran a Robin Hood themed tourist attraction in Nottingham was experiencing financial difficulties. These were greatly compounded by a substantial VAT liability (for which the directors had sought review in late 2006) and an increase in rent from a recent rent review. HMRC upheld the VAT determination in May 2007 and confirmed that position to the company. The company subsequently went into creditors voluntary liquidation on 6 February 2009, and the liquidators brought proceedings under section 214 IA 1986 seeking contribution from the former directors for losses sustained by creditors.

What were the issues?

Of the issues raised before the court, the two key ones were: (i) the interpretation of the company's financial statements and other records in determining the directors' imputed knowledge; and (ii) whether the directors had taken every step to minimise the potential loss to creditors, and what the burden of proof was for this defence.

What did the court decide?

On the knowledge issue, the court decided that although financial statements were not produced until the next financial year, the directors should have used the information which they would ultimately contain in order to assess commercial solvency issues. Whilst the directors ought to have known that they could not afford a time to pay arrangement with HMRC by January 2007, the position was made crystal clear in May 2007 when HMRC upheld their VAT determination. At that point the directors also ought to have been aware that the company could not meet its next payment of rent. Liability therefore accrued from this point.

Looking at whether the directors had taken every step to minimise the potential loss to creditors, the court confirmed firstly that the onus was on the **directors** to prove this (and **not** on the liquidators to prove that they had not). In assessing liability, the court noted that whilst the directors had – by May 2007 – ensured that trade creditors were paid in full, they had not done so with VAT and rent liabilities, which meant that as a class HMRC and the landlord were prejudiced, and the directors could not establish that they had minimised losses to creditors **as a whole**.

What does this mean for practitioners?

This is an important and helpful decision. Previously it has been thought that the entire burden of proof in wrongful trading actions was on the liquidator. This case states the opposite – that once the liquidators have established when the "point of no return" had occurred, it is for the **directors** then to establish they had taken the requisite steps.

It is also clear that merely stating that "most" of the creditors had not been prejudiced is not sufficient to establish a defence. The court will consider the position of creditors as a whole.

We look forward to seeing whether this will be appealed and will report further as and when it does.

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