When does the treatment of the company's interests as being equivalent to the shareholders' interests cease to be justifiable? The momentous decision of the Supreme Court in *BTI V Sequana*

Margaret Griffin and Georgia Purnell

INTRODUCTION

1. After a long 18-month wait, on 5 October 2022 the Supreme Court handed down the ground-breaking judgment in *BTI 2014 LLC v Sequana SA [2022] UKSC 25*.[1] The decision is one of the most eagerly anticipated company and insolvency law decisions in recent years, with Lady Arden regarding the decision *"as momentous a decision for company law as this Court's recent decision in Patel v Mirza [2017] AC 467 was for the law of illegality"*[2] and Lord Reed noting that the issues "*go to the heart of our understanding of company law and are of considerable practical importance for the management of companies".*[3]

2. The Supreme Court's decision concerns the well-established fiduciary duty of directors to act in good faith in the interests of the company. However, *Sequana* is the first occasion in which the highest Court has had the opportunity to consider whether the so-called "creditor duty",[4] a duty on the directors to consider or act in accordance with the interests of the company's creditors when the company is in, is approaching or is at real risk of insolvency, exists at all and, if so, when the duty is engaged and what is its content. The so-called creditor duty originated in Australia but was adopted within the jurisdiction in *West Mercia v Dodd* [1988] BCLC 250.

3. The decision is not only an essential read for those practising in company and insolvency law, but also for professional liability lawyers acting in directors' duties claims. This short case note cannot possibly do justice to the 160-page decision and the incredibly thorough and well-reasoned judgments of Lord Briggs (with whom Lord Kitchin agreed), Lord Hodge, Lord Reed

[1] Square brackets are references to the paragraphs in the Supreme Court's decision, unless otherwise stated.
[2] [248]
[3] [7]
[4] This case note will refer to the duty as "the creditor duty" for convenience and to reflect the view of the majority in the UKSC. Please note that Lord Reed and Lady Arden preferred to describe the duty as "the rule in West Mercia" after the leading case: [11], [257]

and Lady Arden. However, it aims to provide an accessible overview of the decision, alongside providing comment and some brief practical tips.[5]

THE FACTS

4. For present purposes, the material facts can be summarised as follows.

5. In May 2009, the directors of the company in issue, AWA, caused it to distribute a dividend of €135million to its only shareholder, Sequana SA, which extinguished by way of set-off almost the whole of a slightly larger debt owed by Sequana to AWA.

6. It was common ground before the Supreme Court that the dividend paid was lawful i.e. it complied with Part 23 of the Companies Act 2006[6] and with the common law rules about maintenance of capital.

7. The dividend was distributed at a time when AWA was solvent, on both a balance sheet and cash flow basis, with its assets exceeding its liabilities and able to pay its debts as they fell due. However, AWA had long term contingent liabilities of an uncertain amount which gave rise to a real risk, although not a probability, that AWA might become insolvent at an uncertain but not imminent date in the future.

8. AWA entered administration almost a decade later in October 2018.

THE CLAIM AGAINST THE DIRECTORS AND THE DECISIONS OF THE HIGH COURT AND THE COURT OF APPEAL

9. BTI 2014 LLC, as assignee of AWA's claims, brought a claim against AWA's directors to recover an amount equal to the dividend on the basis that their decision to distribute the dividend was in breach of their fiduciary duties to AWA's creditors.[7]

---

[5] **Disclaimer: this case note is not to be relied on as legal advice. It is prepared for marketing purposes only. The circumstances of each case differ and legal advice specific to the individual case should always be sought.**

[6] "The 2006 Act".

[7] This was not the only claim in relation to this dividend, however as this case note concerns the creditor's duty the s.423 claim is not addressed in detail. Briefly, AWA's main creditor also applied to have the dividend set aside as a transaction at an undervalue intended to prejudice creditors pursuant to s.423 of the Insolvency Act 1986, with this claim heard together with BTI's claim against AWA's directors in the High Court before Rose J (as she then was). Liability was found under s.423. However, Sequana went into insolvent liquidation and accordingly no part of the dividend was repaid.

10. BTI's claim pursuant to the creditor duty failed at first instance, before Rose J (as she then was), and in the Court of Appeal.[8] This was because, although the directors had not taken into account the interests of AWA's creditors, the creditor duty was not engaged at the time of the dividend payment. AWA had not then been insolvent, nor was a future insolvency either imminent or probable, in the sense of being more likely than not, even though there was a real risk of it. The Court of Appeal held that the creditor duty did not arise until a company was either insolvent, on the brink of insolvency or probably headed for insolvency. A risk of insolvency in the future, however real, was insufficient unless it amounted to a probability.

ISSUES BEFORE THE SUPREME COURT

11. There were four substantive issues before the Supreme Court:

(i) Is there a common law creditor duty at all?

(ii) Can the creditor duty apply to a decision by directors to pay an otherwise lawful dividend?

(iii) What is the content of the creditor duty?

(iv) When is the creditor duty engaged? Was it engaged on the facts of this case?

12. The majority judgment was given by Lord Briggs, with whom Lord Kitchin and Lord Hodge (in a concurring judgment) agreed, with Lord Reed and Lady Arden each giving judgments which concurred in the result for broadly the same reasons (with some differences). The Supreme Court dismissed BTI's appeal.

ISSUE 1 – IS THERE A COMMON LAW CREDITOR DUTY AT ALL?

13. In the Supreme Court, AWA's directors challenged the existence of the creditor duty. However, the Supreme Court concluded that the creditor duty does exist and should be affirmed because, inter alia,[9] its existence is affirmed (per Lord Briggs and Lord Hodge),[10] or its possible existence is preserved (per Lord Reed and Lady Arden),[11] by s.172(3) of the 2006 Act which provides:

[8] [2019] EWCA Civ 112.
[9] The Court also considered that the creditor duty is supported by a long line of case law within the jurisdiction (alongside authority from Australia and New Zealand) and the duty had coherent and principled justification.
[10] [153], [209], [224].
[11] [69]-[71], [76], [344].

"The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of the creditors of the company".

14. It is worth noting that the Supreme Court did not consider that the shareholder authorisation or ratification principles preventing the recognition of the creditor duty, because there can be no shareholder ratification of a transaction entered into when the company was insolvent (or which would render the company insolvent), nor was there conflict between the creditor duty and the wrongful trading provisions contained in s.214 of the Insolvency Act 1986.[12]

15. All five Justices agreed that the creditor duty is not a free-standing duty that is owed to creditors, or any duty separate from the directors' fiduciary duty to act in good faith in the interests of the company.[13] It is simply a modification of the rule that the company's interests are taken to be equivalent to the interests of the members as a whole, with there being certain circumstances in which those interests should be understood as including the interests of the company's creditors as a whole.

ISSUE 2 – CAN THE CREDITOR DUTY APPLY TO A DECISION BY DIRECTORS TO PAY AN OTHERWISE LAWFUL DIVIDEND?

16. The Supreme Court determined that the creditor duty can apply in these circumstances, given:[14]

(i) Part 23 of the 2006 Act is subject to any rule of law to the contrary (s.851(1)). As the creditor duty is part of the common law and recognised by s.172(3) of the 2006 Act it is not excluded by Part 23.

(ii) A decision to pay a dividend that is lawful may still be taken in breach of duty.

[12] "The 1986 Act".
[13] [11], [112], [135], [261]-[277]
[14] [110], [160]-[162], [247], [342]

ISSUE 3 – WHAT IS THE CONTENT OF THE CREDITOR DUTY?

17. Each of the judgments provide extremely important guidance about the circumstances in which the creditor duty may be triggered prior to insolvency and the content of the creditor duty where triggered. In summary:

(i) The duty requires the directors to take into account and give appropriate weight to the interests of the creditors as a general body and to balance them against shareholders' interests where they may conflict. The greater the company's financial difficulties, the more the creditors' interests will predominate i.e. the more the directors should prioritise the creditors interests.[15]

(ii) Lady Arden, however, considers a "sliding scale" analogy should not be taken too literally, as the progress towards insolvency may not be linear or occur as a result of incremental developments but it may arise as a result of something which has a major and sudden impact on the company – directors should, accordingly, stay informed of the company's financial position.[16]

(iii) Although expressed slightly differently, the Justices agree that it is only where insolvent liquidation or administration is inevitable, where there is no light at the end of the tunnel, that the creditors' interests become paramount as the

(iv) shareholders cease to retain any valuable interest in the company.[17] Lord Briggs suggests that this is the point that s.214 of the 1986 Act also becomes engaged.[18]

ISSUE 4 – WHEN IS THE CREDITOR DUTY ENGAGED?

18. At what point do directors have to consider the interests of the creditors? In the Court of Appeal, David Richards LJ (as he then was) conducted a thorough review of the relevant English and Commonwealth authorities but could not find any clear guidance as to a precise

[15] [81], [176]
[16] [303]-[304]
[17] [81], [176], [247], [291], [306]. Lord Hodge uses the term "irretrievably insolvent", and Lady Arden uses the term "irreversibly insolvent".
[18] [176]

answer to the "when" question.[19] Dicta could be found to support a range of competing alternatives, from real risk of insolvency as the earliest to actual insolvency at the latest.

19. The Supreme Court concluded that the duty is not triggered merely by a real and not remote risk of insolvency.[20] This was sufficient to decide the appeal against BTI.

20. Each of the judgments also provides helpful guidance on the trigger for the engagement of the duty, notably disagreeing with the Court of Appeal's view that the duty is triggered merely because insolvency is probable (more likely than not):[21]

(i) Lords Briggs, Kitchin and Hodge held that the trigger is either imminent insolvency (i.e. insolvency which directors know or ought to know is just around the corner and going to happen) or the probability of an insolvent liquidation (or administration) about which the directors know or ought to know, are sufficient triggers for the engagement of the creditor duty.[22] Lord Briggs rejected that the probability of insolvency itself was sufficient, with the bare probability of insolvency, which may be temporary, does not of itself make liquidation (or administration) probable.[23]

(ii) Lord Reed noted he was less certain than Lords Briggs and Hodge that it is essential that the directors "know or ought to know" that the company is insolvent or bordering on insolvency, or that an insolvent liquidation or administration is probable, but it was unnecessary and inappropriate to express a concluded view.[24]

(iii) Lady Arden noted she would leave the question of relevant knowledge open for full submissions.[25]

KEY TAKEAWAY POINTS

21. The key points to note from the Supreme Court's decision are:

[19] As termed at [179]
[20] [14], [83], [199], [306]
[21] [213]-[220] of the Court of Appeal decision.
[22] [203], [227]
[23] [202]
[24] [90]
[25] [281]

(i) Existence of the creditor duty. The duty exists but not as a separate duty from the directors' fiduciary duty to the company.

(ii) Content of the duty. The creditors' interests only become paramount when the company becomes irreversibly or irretrievably insolvent.[26]

(iii) Engagement of the duty. The duty does not arise merely because the company was at a real and not remote risk of insolvency. The majority considered the trigger is either imminent insolvency (an insolvency which the directors know or ought to know is going to happen and is on the horizon) or the probability of an insolvent liquidation or administration (about which the directors know or ought to know).[27] Lord Reed and Lady Arden have expressed reservations about the knowledge requirement, but considered it unnecessary to express a concluded view until the issue arose, with the Court not to consider itself bound by its obiter views.

COMMENT

22. The Supreme Court's decision is undoubtedly one of the most important company and insolvency law decisions in recent years. It is particularly important for directors and insolvency practitioners, and those advising them.

23. The affirmation of the creditor duty, confirmation that a real risk of insolvency is not sufficient to trigger the duty and the dicta on the content and engagement of the duty provides helpful clarification, particularly for directors navigating challenging economic times and insolvency practitioners looking to bring claims during the rise of corporate insolvencies.

24. For directors, the Supreme Court's acknowledgment that a real risk of insolvency is a common feature and may be temporary, so as not to trigger the duty, and the dicta that the directors must have knowledge (or ought to have knowledge) of the probability of entering insolvent liquidation (or administration), as opposed to simply the probability of insolvency, will provide some welcome relief to those currently

[26] Obiter.
[27] Obiter.

involved in the management of companies and those defending claims. The distinction between the probability of insolvency (i.e. balance sheet or cash flow insolvency) and that of entering insolvent liquidation or administration is an important one, with far more companies likely facing the probability of insolvency than the probability of liquidation or administration. However, directors and their advisers should be mindful of the potential existence and scope of the duty when making corporate governance decisions and when taking other ancillary measures to their office, such as taking out or renewing D&O insurance. Further, directors and their advisors should heed the message which the Supreme Court intended to send out, that directors must stay informed and always have access to reasonably reliable information about the company's financial position, by reference to up to date accounting information.[28]

25. For insolvency practitioners looking to bring claims, given the Supreme Court has (albeit *obiter dicta*) tightened the position, careful thought needs to be given as to whether the duty is in fact engaged. Even before the Supreme Court's decision, practically, an office holder would have had to have been bold to bring a claim based on prospective insolvency alone. However, the decision has set the bar even higher and is likely to have far reaching practical implications, with office holders needing to consider whether it can be shown that if not actually insolvent or bordering insolvency, that there is probability of an insolvent liquidation or administration, rather than a mere probability of insolvency. Office holders would also be well advised to consider before issuing a claim whether they are likely to satisfy the knowledge requirement suggested by Lords Briggs, Kitchin and Hodge, albeit this requirement is not settled and it is likely to be given some consideration by lower courts.

26. As interesting and enlightening this decision by the Supreme Court is, a number of questions remain unresolved. A conclusive judgment on the content and trigger for the duty is required to give greater certainty in this area. Further, the Court expressly left open several other issues not addressed in this case note, including the scope of liability and relief. *Sequana* is, undoubtedly, seminal, but this area of law will inevitably continue to develop.

MARGARET GRIFFIN

GEORGIA PURNELL

Hailsham Chambers

6 October 2022

[28] [304]

About the authors

Margaret Griffin (Call: 2004) has a formidable reputation in the fields of commercial, commercial chancery and professional liability litigation. Margaret has particular expertise in dealing with contentious trust matters, claims by and against trustees, director and officer (D&O) claims, shareholder claims, property disputes, civil fraud matters and professional negligence of solicitors, barristers and surveyors, architects and other professionals.

Georgia Purnell (Call: 2018) is a commercial litigator who practises exclusively in banking and financial services litigation, commercial fraud and asset recovery, company and insolvency matters and commercial professional liability disputes. Georgia primarily acts in litigation involving accessorial liability, banking and financial institutions' liability, breach of fiduciary duty, breach of trust, conspiracy, directors' and officers' (D&O) claims and financial, banking and investment fraud.