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ARTICLE

The Supreme Court's Decision in *BTI 2014 LLC (Appellant) v Sequana SA and others (Respondents)* [2022] UKSC 25: Is This a Case of All Change or No Change? Or Is It Somewhere in Between?

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Synopsis

'This appeal raises questions of considerable importance for company law. It concerns the fiduciary duty of directors to act in good faith in the interests of the company. In this context, the interests of the company have until recent times been treated as being the interests of its members as a whole. So understood, the duty has been given statutory expression in a modified form in section 172(1) of the Companies Act 2006 [('the 2006 Act')], which requires directors to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. However, where the company is insolvent or, according to some authorities, is at some earlier point in the decline of its fortunes, it has been said that the duty to act in the interests of the company should not be interpreted as a duty to act in the interests of the members as a whole, but should instead be understood as a duty to act in the interests of the company's creditors as a whole, or as a duty to take the creditors' interests into account together with those of the members…

…the proposition that directors are under a duty in respect of creditors' interests raises a number of questions. For example, is it correct to say that there is such a duty? If it is, when does the duty arise: on insolvency (however that may be defined), or at some earlier point? What is the content of the duty? Is it a duty to treat the creditors' interests as paramount, or are they merely to be treated as a relevant consideration, along with others? What are the consequences of a breach of the duty? In particular, what forms of relief are available? These are only a few of the questions which arise…

This appeal is the first occasion on which any of these issues has had to be decided by this country's highest court. They go to the heart of our understanding of company law, and are of considerable practical importance to the management of companies…'

So said Lord Reed in the portentous opening paragraphs of his judgment in *BTI 2014 LLC v Sequana SA*. He was one of the five Supreme Court Justices who heard this appeal in May 2021. The appeal was unanimously dismissed on 5 October 2022, in the form of a 160 page judgment, comprising separate judgments from four out of the five[1] Justices who heard the appeal.

This article analyses this hugely anticipated decision and considers the extent to which the landscape has changed for directors, insolvency practitioners and those who advise them. Is this new law? Is it welcome clarification? Or is it something else altogether?

Facts

In May 2009 the directors of Arjo Wiggins Appleton Limited ('AWA') declared a dividend of €135m (the 'Dividend Payment') to be paid to its sole shareholder, Sequana SA ('Sequana'). By way of set-off the Dividend Payment satisfied (almost entirely) a debt owed by Sequana to AWA.

The Dividend Payment was made at a time when AWA was unquestionably solvent, both on a balance sheet basis and on a cash flow basis. The Dividend Payment was made in proper compliance with: (a) Part 23 of the 2006 Act (the statutory regime applying to dividends); and (b) the common law rules about maintenance of capital.

AWA was non-trading. It had long-term contingent liabilities in respect of the future clean-up costs of a polluted US river. The extent of these potential liabilities was largely an unknown; hence an estimated provision had been included in AWA's accounts to meet them. One of AWA's assets (that would be used to meet the future indemnification costs) was an insurance portfolio, the value of which was also considered to be uncertain.

Notes

1 Lady Arden and Lord Briggs (with Lord Kitchin concurring) with Lords Hodge and Reed, reaching the same conclusion with different or additional reasoning.

Taking these factors into account there was a real risk (although not a probability) that AWA might become insolvent at an uncertain date in the future (although not imminently).

AWA went into insolvent administration in October 2018, nearly ten years after the Dividend Payment was made. BTI 2014 LLC ('BTI') took an assignment of AWA's claims and, as assignee, sought to recover €135m from AWA's directors on the basis that they had breached their duty to consider or act in the interests of creditors in awarding the Dividend Payment (the 'Breach of Creditor Duty Application'). Separately, an application was made by AWA's main creditor to have the Dividend Payment set aside as a transaction at an undervalue, pursuant to section 423 of the Insolvency Act 1986 (the 'Section 423 Application').

First instance and Court of Appeal judgments

Both applications were heard in the High Court before Rose J (now Lady Rose, herself a Justice of the Supreme Court). The Section 423 Application was successful, although as Sequana had by then gone into insolvent liquidation no recovery was made.

The Breach of Creditor Duty Application was dismissed both by the High Court and by the Court of Appeal. The Court of Appeal ([2019] EWCA Civ. 112) held that the creditor duty had not arisen (on the facts) and would not arise until one of four criteria were met, these being that: (1) AWA was actually insolvent; (2) AWA was on the brink of insolvency; (3) AWA was 'likely to become' insolvent (on the basis that 'likely' means 'probable' or in simple terms more than a 50% prospect) or (4) there was a real, as opposed to a remote, risk of AWA's insolvency.

BTI appealed to the Supreme Court.

The appeal to the Supreme Court

The appeal was unanimously dismissed.

This was the first occasion on which the Supreme Court had been asked to decide: (1) whether there are circumstances in which directors must act in, or at least consider, the interests of the company's creditors; and (2) whether, in circumstances where a company is solvent, the duty requiring directors to consider the interests of creditors is nonetheless engaged.

The Respondents argued first, that there is in fact no duty to act in the interests of creditors under English common law; secondly, that if such a duty exists it cannot apply to restrain the payment of a lawful dividend; and thirdly that any such duty does not arise until a company's actual or imminent insolvency.

The Supreme Court, whilst disagreeing with the Respondents' first two arguments, held that the AWA directors (the Second and Third Respondents) were not under any duty to consider or act in the interests of creditors when making the decision to approve the Dividend Payment.

The issues before the Supreme Court, the rulings and the reasoning

The Supreme Court addressed four key issues:

First – Is there a common law creditor duty at all?

The Supreme Court confirmed the existence of a common law duty (consistent with section 172(3) of the 2006 Act) whereby directors, in certain circumstances, must consider or act in the interests of creditors of a company. The duty is part of the directors' fiduciary duties to act in good faith for the benefit of the company. It is not a freestanding duty. When the duty is triggered, 'the interests of the company' will include (and therefore expand) the interests of creditors as a whole/ as a body. As between the Justices there was disagreement as to how this duty should be characterized . The majority adopted the description of this duty as 'the creditor duty'.

On the minority, Lord Reed likened the duty to a modification of the rule in *West Mercia Safetywear v Dodd*;[2] confirming that there was no separate 'creditor's interest duty', only a director's duty to act in good faith in the interests of the company. The company's interests are those of its members as a whole and should be taken to also include the interests of its creditors as a whole. He added that as a company experiences financial difficulties, the balance of considerations begins to shift from shareholders to creditors. Where a company then reaches the point at which insolvent liquidation or administration is inevitable, the interest of members ceases and the company's interests at that point become solely the interests of creditors as a whole.

Second – Can the creditor duty apply to a director's decision to pay a lawful dividend?

It was held that even where a dividend is awarded lawfully, in accordance with the relevant provisions of the 2006 Act, there are two instances where such dividend payment would be a breach of the creditor duty: (1)

Notes

2 [1988] BCLC 250; directors have a duty to consider the interests of creditors in certain circumstances, specifically when the directors know, or ought to know, that the company is (or is likely to become) insolvent.

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section 851(1), part 23 of the 2006 Act provides that the authority in part 23 to award and make a dividend payment is *'without prejudice to any rule of law restricting the sums out of which, or the cases in which, a distribution may be made'*. Thus, the creditor duty, recognised under section 172(3) of the 2006 Act and at common law as a duty, is not excluded by part 23; and (2) Part 23 identifies monies available for distribution on a balance sheet basis; however, in circumstances where the company was at the material time cash-flow insolvent, any dividend payment (whilst lawful) would be in breach of the creditor interest duty.

Third – What does the creditor duty comprise?

In perhaps the most welcome (but arguably unsurprising) aspect of the judgment, the Supreme Court confirmed that the scope of the creditor duty required directors to take into account the interests of creditors as a body and give sufficient weight on a *'sliding scale'* (emphasis added[3]). The practical effect being that once the duty is engaged the directors should consider the interests of creditors, balancing them against the interests of shareholders, and give increasing weight to the interests of creditors as the company's financial difficulties become greater. The judgments confirm that if or when a company subsequently reaches a point where insolvent liquidation or administration becomes inevitable, the interests of creditors becomes paramount as at that point the shareholders cease to have any economic interest in the company.

Fourth – When is the creditor duty engaged?

The Supreme Court clarified that a real and not remote risk of insolvency was not enough and that the 'trigger point' for when the creditor duty commences is when the company is either: (Trigger point 1) insolvent; (Trigger point 2) bordering on insolvency; or (Trigger point 3) when an insolvent liquidation or administration is probable. This represents a shifting of the dial to a point in time which is closer to actual insolvency (rather than mere risk of insolvency).

The majority held that the creditor duty is engaged when the directors knew or ought to have known about the insolvency/bordering insolvency/probable liquidation or administration (a combined subjective and objective test). Unhelpfully in this regard, the Supreme Court did not address the circumstances in which it can be found that a director knew, or ought to have known, that the relevant trigger point (be it 1, 2 or 3) had been reached. The Court did, however, observe (again unsurprisingly) that there is a general presumption that directors should take all steps necessary to ensure they keep abreast of the affairs and financial position of the company at all times.

Discussion

Whilst the exhaustive analyses contained in the four judgments contain welcome clarification in a number of respects (not to mention a careful trawl through English and Australian caselaw), overall, the decision makes little change as far as the established existing common law is concerned.

However, in the opinion of your author, the decision is important in three respects:

- we have clarity on the thresholds for the various trigger points for the engagement of the creditor duty
- we have a recognition that the question of insolvency is a nuanced one; not all insolvency is terminal; insolvency will not invariably trigger the creditor duty
- we have a warning note on dividends and solvency.

Clarity

That the mere *risk* of insolvency will not of itself engage the creditor duty. This is not only a welcome shift from the prior jurisprudence; it is also common sense. As Lord Reed observed at [50]: 'A company may become insolvent without there being any reason to believe that insolvency proceedings are inevitable'.

The threshold for the 'trigger point' is now higher – indeed significantly higher: actual insolvency, probable insolvency, or bordering on insolvency. The trigger point is not only higher than it was pre-*Sequana*, it is also, importantly, more certain. Directors do not have to struggle with the vagaries of 'real risk' of insolvency, or 'probable' insolvency. As Lord Briggs observed at [173] 'practical common-sense points strongly against a duty to treat creditors' interests as paramount at the onset of what may be only a temporary insolvency'.

As far as the three trigger points identified above are concerned, they have the absolute certainty of actual insolvency (trigger point one) and the relative certainty of 'probable' insolvent liquidation or administration (trigger point three). Although 'bordering on insolvency' (trigger point 2) is not free from ambiguity, plainly it means more (and significantly more) than a mere 'risk', or mere 'real risk' of insolvency.

To this extent, the decision will be reassuring to directors (and disappointing to any previously trigger-happy insolvency practitioners). The decision is a pragmatic

Notes

3 See paragraphs [303] and [419] of Lady Arden's judgment.

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one (not least given the economic crisis facing the UK), acknowledging as it does the 'development of the modern corporate rescue culture' (Lord Briggs at [151]).

As Lady Arden emphasized at [248] 'Modern insolvency legislation encourages the rescue of companies in financial difficulty rather than liquidating them. To achieve a rescue, directors need to be able to take the necessary steps, for instance to raise fresh funding even though the position of creditors is precarious'

Nuance

Trigger point 2 is rather more nuanced than might be thought as a matter of first impression. When the company is insolvent or bordering on insolvency, but liquidation or administration is not inevitable, the creditor duty is engaged. However, this does not mean that at this stage creditors' interests are inevitably paramount.

Yes, the duty having been engaged, directors are required to consider creditors interests as a whole but they are entitled to (and indeed should) balance them against the shareholders' conflicting interests when considering the risk/benefit of a transaction. This is a matter of commercial judgment (albeit one that should be exercised on an informed and rational basis). This exercise might lead to the conclusion that in the particular instance, the creditors' interests are not paramount (see the observations of Lord Hodge at [238]). In other words, there may be instances where the creditors' interests may be displaced, with the consequence that the failure properly to consider shareholders' interests (or a decision to subordinate shareholders' interests) will itself be impeachable as a breach of duty, on the footing that the balancing exercise has not properly been undertaken.

Solvency and dividends

Within the framework of weighing shareholders' interests into the balancing exercise, the finding that the creditor duty can apply to a decision to pay a lawful dividend is thrown into sharp relief. Hence, although prima facie, shareholder interests would have primacy in circumstances where the company accounts show that there are sufficient distributable reserves, the directors still have to be careful.

Questions remaining and lessons to be learned?

The emphasis in the judgments on a duty to creditors as a 'body' or 'as a whole' has practical difficulties and could be confusing to directors. For a start, the 'body' of creditors, or creditors 'as a whole' means that all creditors must be treated as one class, including those in a 'special' position (such as secured, subordinated, preferential, contingent etc. creditors) (per Lord Reed at [48]). Yet it is not difficult to conceive of a scenario in which the directors could legitimately give consideration (or properly should give consideration) to a particular creditor or creditor group and conclude that the payment of one creditor (or one creditor class) over another would be justified, especially if that payment was required to keep the shutters up. Conversely, will directors not be required to consider the position of individual creditors? Surely, they should do so if the circumstances so require?

Moreover, the Court did not articulate any precise or specific test for working out exactly *when* the creditor duty is engaged. Whilst it would be comforting to have some guidance from 'on high', this omission (if it can fairly be called one) is not surprising; the question is fact specific and is a matter for the directors' commercial judgment, depending on the pertaining facts.

The clarity that we now have makes it still less excusable for directors not to have reliable, regular and up-to-date financial information, including as to short-term cash flow and creditor status. Boards need to bear in mind that (as confirmed by the Supreme Court), at the point at which the creditor duty is engaged, shareholders cannot authorise or ratify a director's breach of that duty.

Plainly, there is a requirement that directors should monitor and be aware of their company's solvency at all times (and to prioritise creditors' interests as appropriate). This is trite, well-known and uncontroversial. That said, given that we now have clarity on the 'trigger-points', it should (as a matter of practicality) be easier for boards both to make – and to record – their deliberations and decisions with discipline, by anticipating the engagement of the creditor duty and in discharging that duty when it is engaged (and therefore to take professional advice at the earliest opportunity). This is particularly important in circumstances where the Board is considering declaring dividends.

Conclusion

On any view, this decision is not an all-embracing one. The Supreme Court itself acknowledged that the law continued to develop and evolve. At [4] of his judgment, Lord Reed was at pains to point out that not all of the questions which arose needed to be – or could be – addressed by the Court:

> 'As this is also an area of the law which is in the course of development, and many aspects of which remain controversial, it would be unwise as well as inappropriate to attempt to answer all these questions in the present case... It is therefore necessary to express a provisional view about some issues which do not call for a final decision'.

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Indeed, in a number of respects what has been left open and unanswered by the Justices is of itself of real significance. In particular, although it was touched upon, the Court left open the question of whether it is an essential component of their liability that the directors know or ought to know that the company was insolvent or bordering on insolvency or that an insolvency process was probable (in other words, that a trigger point had been reached).

Inevitably therefore, the decision (and in particular those matters which were left open) will spawn further litigation and still further jurisprudence.

Nonetheless, we conclude this article on a positive note. We have welcome clarity on the 'trigger points' and – to cut to the chase of those 160 pages – we have, in substance, a pragmatic decision that recognises and accommodates the commercial pressures and commercial realities that directors face and which provides a roadmap for professional advisers.

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International Corporate Rescue

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