St Philips BARRISTERS

THE DUTY TO CREDITORS

BTI 2014 LLC V SEQUANA SA & OTHERS [2022] UKSC 25

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TOP RANKED Chambers UK Bar 2022 St Philips Chambers

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The LEGAL 500 UNITED KINGDOM TOP TIER SET 2022

AGENDA

01 Introduction

02 Summary of Facts

03 Key Points of Law and Reasoning

04 Unanswered Questions

05 Practical Advice

INTRODUCTION 1

- 17 months for judgment
- 160 pages and 451 paragraphs (although Lady Arden had over 200 of them to herself)
- "*questions of considerable importance for company law*" (Lord Reed)
- "*momentous a decision for company law*" (Lady Arden)
- Thousands of lines of articles written on it already

INTRODUCTION 2

BUT is it really worth all the fuss?

INTRODUCTION 3

1. Not seriously argued by (most) company lawyers that should be no form of “the creditor duty” [n.b. part of directors’ fiduciary duty to the company]

2. No previous case which turned on the existence of such a duty prior to actual insolvency

3. Actual insolvency as understood by reference to s.123, **IA 1986** involves elements of futurity:
   - **Re Cheyne Finance Plc [2008] Bus LR 1562**: cash flow test – includes debts due in reasonably near future – but needs to be an endemic shortage of working capital rather than a temporary lack of liquidity
   - **Eurosail [2013] 1 WLR 1408**: balance sheet test – contingent and prospective liabilities

4. Is “*imminent insolvency*” or “*bordering on insolvency*” different from actual insolvency?

INTRODUCTION 4

- Lord Briggs (with whom Lord Kitchen agreed)
- Lord Reed
- Lord Hodge
- Lady Arden

THE FACTS

- May 2009 – AWA's directors caused it to distribute a dividend of € 135m to its only shareholder – Sequana
- That dividend extinguished a debt owed by Sequana to AWA
- The dividend was lawful for the purposes of the **CA 2006**
- AWA was solvent on a balance sheet and cash flow basis
- It had a long-term contingent liability of uncertain amount
- That gave rise to a real risk, but not a probability, that AWA might become insolvent at an uncertain, but not imminent date in the future
- October 2018 – AWA went into insolvent administration
- BTI, as assignee of AWA's claims, claimed the amount of the dividend from the directors

KEY POINTS
Does the Duty Exist at All?

LORD BRIGGS (& LORD KITCHEN)

- "*Creditor duty*"
- Prospect that creditors may have the main economic stake in liquidation Ratification principle can readily adapt to creditor duty
- S.214 not a bar
- Long line of authority
- S.172(3) **CA 2006**

LORD REED

- "*rule in West Mercia*"
- Interests of creditors as a class in company's affairs

LORD HODGE

- "*West Mercia duty*"
- Creditors as a body have a form of stakeholding
- S.172(3)
- Assists professional advisers to encourage directors to act responsibly

LADY ARDEN

- "*rule in West Mercia*"
- Redresses situation in which creditors with greater economic interest have no control
- Different views as to s.172(1) and (3)

KEY POINTS
When is the duty engaged?

LORD BRIGGS (& LORD KITCHEN)

- "*imminent*" insolvency (directors know or ought to know is just around the corner and going to happen); or
- "*probability*" of an insolvent liquidation (or administration) about which the directors know or ought to known

LORD REED

- "*insolvent or bordering on insolvency*" or where insolvent liquidation or administration is "*probable*" (at [12])
- But not inclined to agree that "*likelihood [of insolvency] is sufficient*"
- But less certain about requirement for directors to "*know or ought to know*"

LORD HODGE

- "*insolvent or bordering on insolvency*"
- Where directors "*know or ought to have known*" that the company has become *"irretrievably insolvent..."*
- [subject to comments agrees with Lord Briggs]

LADY ARDEN

- Whenever a company is "*financially distressed*" as per Lord Reed at [12] (inc where plan to enter into transaction...)
- Leave question of knowledge open but may be closer to s.214 **IA86**

KEY POINTS "Insolvency"

- Court heard no submissions on the point (!) (Lord Reed at [88])

- Lord Briggs (& Lord Kitchen): two forms of insolvency (s.123 **IA86**) and notes that a company "*may experience short-term commercial insolvency*" or be "*balance sheet insolvent*" because it is a start-up and yet there is "*light at the end of the tunnel*" (at [120])

- Lord Reed: inclined to think that tests are in s.123 (at [88])

- Lord Hodge: agrees with Lord Briggs subject to comments (and none on this point)

- Lady Arden: start with s.123 but tests to be "*applied with the degree of flexibility appropriate to the rationale and context of the Rule in West Mercia*"; "*has also to be some minor latitude allowed so that prompt payment is not insisted on*" (at [308]); and "*agrees*" with Lord Briggs that "*temporary commercial insolvency should be excluded*" (at [309])

KEY POINTS
What is the content of the duty?

- The directors' duty is to act in the interests of the company
- But where the rule applies, the interests of the company are no longer solely the interests of the shareholders
- They include the interests of creditors as a whole
- But only where insolvent liquidation or administration is inevitable do the shareholders have no interest at all
- As a result, there is a balance to be struck between shareholders' interests and creditors' interests

KEY POINTS

Does the duty apply to a lawful dividend?

In short – yes

- The provisions relating to dividends in the **CA 2006** do not oust other duties, such as the creditor duty

- Those provisions look only to the balance sheet – whereas the creditor duty looks to cash flow solvency as well

UNANSWERED QUESTIONS & AREAS FOR DEVELOPMENT

INTERACTION WITH SECTION 239 IA86

Lord Reed:

- Obvious differences
- Plainly s.239 cannot be determinative of issues of breach of duty
- Provisional view that ***West Mercia*** correct re relief (at [105])

Lady Arden agrees with that provisional view (at [327] and [402])

PROPER PURPOSE DUTY

Lord Reed:

- s.171 may include advancing interests of creditors

Lord Hodge:

- In most circumstances s.172(3) would be irrelevant to s.171 duty but link

Lady Arden:

- ***West Mercia*** = improper purpose

UNANSWERED QUESTIONS & AREAS FOR DEVELOPMENT

INTERACTION WITH SECTION 214 IA86

Section 214 applied later than the creditor duty

Section 214 is a more onerous duty

Difference in remedies?

Section 214 can only apply if there is a winding up

Only a liquidator can bring proceedings under section 214

Section 214 can only be used against a director or former director

ADVISORY

1. In theory, duty will arise in narrower circs than as per CA, but difficult factual inquiries remain

2. According to Lord Hodge it may only be "*in rare circumstances*" that issue arises whether should be a remedy outside s.214

3. Balancing exercise: a reasonable decision to attempt to rescue a company's business in the interests of members and creditors unlikely to be a breach

4. But caution against "insolvency-deepening" activity: probably have to enter formal insolvency but a prospect of return to solvency if the company undertakes a particularly risky transaction (but if fails will deepen insolvency)

5. Principles of ratification unchanged.

PRACTICAL ADVICE

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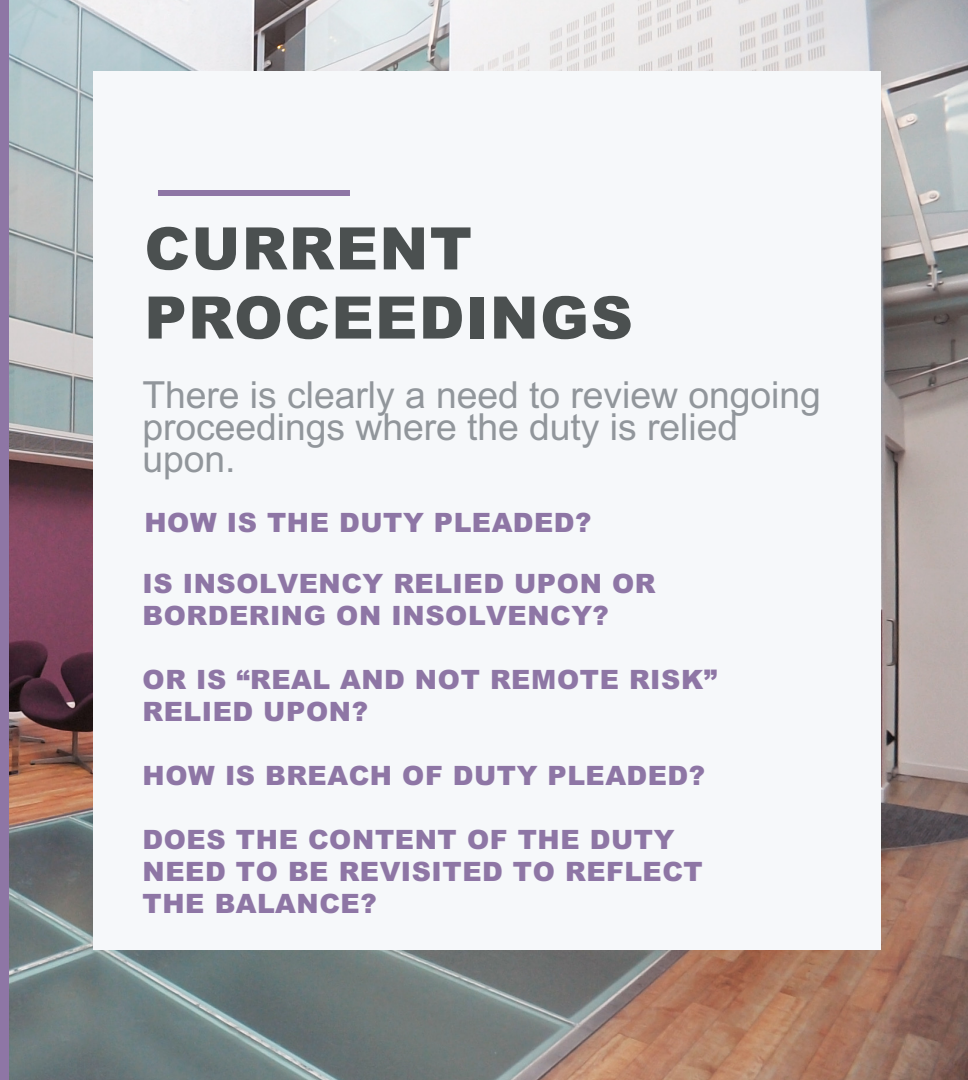

CURRENT PROCEEDINGS

There is clearly a need to review ongoing proceedings where the duty is relied upon.

HOW IS THE DUTY PLEADED?

IS INSOLVENCY RELIED UPON OR BORDERING ON INSOLVENCY?

OR IS “REAL AND NOT REMOTE RISK” RELIED UPON?

HOW IS BREACH OF DUTY PLEADED?

DOES THE CONTENT OF THE DUTY NEED TO BE REVISITED TO REFLECT THE BALANCE?

“A STELLAR SET COMPRISED OF COUNSEL OF EXCEPTIONAL ABILITY”

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