insolvency lawyers' association

Technical Bulletin 1025

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Case: BTI 2014 LLC v Sequana SA and ors [2022] UKSC 25, Lords Reed, Hodge, Briggs, Lady Arden, Lord Kitchin

Synopsis: The Supreme Court held that the common law duty of directors to creditors (which is not a direct duty but an aspect of the directors' duties to the company) does not apply because the company is at a real and not remote risk of insolvency at some point in the future.

Topics covered: **Dividends; directors duties; section 172(3) CA 2006**

Comment

Anticipating the discussion at the ILA's upcoming annual conference, perhaps the most important question raised by this case was whether it will change advice on the ground. The prevailing view appears to be that in most cases, it will make only a nuanced, and not a material, difference. It is notable that all their Lordships firmly pitch the point at which the creditor duty (described further below) is engaged towards the end of the spectrum of possibilities, preferring the concept of imminence which David Richards LJ had explicitly rejected in the Court of Appeal. Before this case, there was very little clarity on when the duty was engaged with three broad formulations emerging from the case law: where insolvency was imminent; where solvency was doubtful; or, more recently, where there was a real and not remote risk of insolvency. Against this background, the case is significant in positioning the point at which the duty is engaged in the 'imminent' bucket. Imminence remains, however, a difficult point to identify in practice and therefore practitioners may prefer in some circumstances to err on the side of caution in their advice. However, it may also be possible to conceive of circumstances in which advice on whether the duty was engaged or not would have been cautious in the past but may now perhaps be more robust.

Lord Briggs's hints that the fact that the May dividend may have been a breach of duty simply because it offended s423 IA 1986 is intuitively appealing. It is arguably surprising that directors could act for the purpose of putting assets beyond the reach of creditors without that amounting to a breach of duty in circumstances where the company is solvent at the time. However, Lord Briggs does not develop his point (given that it was not part of the claim) and it is not immediately clear how he considers the claim could have been framed in the context of the other directors' duties. This task is not made any easier by the mixed discussion of these duties in the judgments. Interestingly, in the Court of Appeal an alternative claim for breach of s171 CA 2006 (the duty to exercise powers for their proper purpose) did not succeed because it had not been separately pleaded; the directors had not been party to the s423 claim; and it was not necessary for the statutory purpose to be the sole, dominant or causative purpose for s423 while this would need to have been established for the purposes of s171. There were also questions on ratification. A claim for breach of s174 IA 1986 was similarly said to be subject to difficulties. Readers may wonder whether following the Supreme Court judgment, one of these other grounds may have been successful and we may see cases pleaded on multiple heads in the future.

Finally, there is discussion of various issues in this rich and detailed judgment which may have relevance to other areas of insolvency law. For example, the discussion of whether 'insolvent' is always synonymous with the interpretation given to s123(1)(e) and s123(2) may be of wider application; the discussion of the meaning of 'economic interest' may be relevant in the context of Part 26A restructuring plan procedures; and the discussion of whether the company must have suffered a loss in the conventional, balance sheet sense for the purposes of a preference-like claim may also be relevant for the debate about whether the grant of security can amount to a preference. In other words, there may be more to this judgment than a first reading suggests, and it seems possible that it will be important not just for cases on the creditor duty itself, but also for cases with a wider context.

Facts

This case is an appeal from a judgment of the Court of Appeal given by David Richards LJ (see technical bulletin 849) relating to the payment of a dividend by Arjo Wiggins Appleton Limited to its parent company, Sequana SA. David Richards LJ held that the dividend payment was a breach of s423 IA 1986. However, he also held that the directors did not breach the common law duty to creditors in authorising the dividend because that duty is triggered when the directors know or should know that the company is likely to be insolvent, where "likely" means probable, and the company had not reached this point when the dividend was paid. He declined to decide whether, once the duty is triggered, the creditors' interests are paramount or are to be considered without being decisive, other than to say that, where the directors know or ought to know that the company is presently and actually insolvent, 'i*t is hard to see that the creditors' interests could be anything but paramount*'. This finding on duties was the subject of the appeal to the Supreme Court (because, as Lord Reed puts it in his judgment, success on the s423 ground was '*of questionable value because of the recipient's having entered insolvency proceedings'* (at [60]) and four issues were before the 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?

Decision

The judgment in the case runs to 160 pages with four, separate judgments (Lord Reed; Lord Briggs (with whom Lord Kitchin agreed); Lord Hodge; and Lady Arden). It is difficult to establish the ratio of the case, but it may be limited to the findings that (i) there is a common law duty of directors to creditors; (ii) this is not a direct duty but an aspect of the directors' duties owed to the company (together (i) and (ii) for the purposes of this bulletin are described as "creditor duty" adopting the nomenclature of Lord Briggs); and (iii) this duty is not triggered when the company is at a real and not remote risk of insolvency at some point in the future. Their Lordships also all agree that: the shareholder ratification principle cannot cure a breach of the creditor duty because ratification will only apply to a solvent company; the creditor duty can apply to a decision by directors to pay a dividend; when triggered, the duty requires directors to take into account the interests of creditors as a whole; and creditors' interests become paramount where insolvent liquidation or administration (not just insolvency) is inevitable. For Lord Briggs this happens when s214

IA 1986 is engaged, while other judges would leave the relationship between the creditor duty and the statutory scheme for another day.

The judgment ranges across many other issues on which their Lordships subtly disagree on many important points of principle.

All the judgments engage with the question of the content of the creditor duty before insolvent liquidation or administration is inevitable but with different emphasis. Lord Reed appears to suggest a sliding scale on which the duty to creditors increases as the financial position of the company deteriorates (at [81]). Lord Briggs also focuses on how near the company is to inevitable insolvency (what he calls the '*light at the end of the tunnel'*) but also focuses on how likely the proposed course of action is to lead the company away from threatened insolvency which '*may well depend on a realistic appreciation of who, as between creditors and shareholders, then have the most skin in the game'* (at [176]). Lady Arden whilst recognising that a sliding scale provides some assistance, voices caution noting that '*the analogy with any such scale should not be taken too literally'* and that '*progress towards insolvency may not be linear'* (at [303]). Similarly, Lady Arden considers that the duty is not limited to considering creditors' interests at all material times but is also a duty not to harm their interests (at [288]).

On the crucial question of when the creditor duty is engaged the majority conclude that it is when 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. However, both Lord Reed (at [90]) and Lady Arden (at [281]) leave open the question of knowledge for an occasion on which full submissions are made on the point. There are also important differences on the meaning of 'insolvency' in this context. Lord Reed inclines towards the tests in s123(1)(e) and s123(2) of the IA 1986 (at [88]) while Lady Arden cautions the need for flexibility with s123 (at [308]) and prefers a test of '*irreversible insolvency*' and considers Lord Briggs to be adopting a similar position in focusing on whether there is '*still light at the end of the tunnel'* (at [307] – [311]).

Finally, the judgments touch on several other important points which are not always fully developed. Many of the judgments consider how the creditor duty relates to other provisions of insolvency law, including s214 and s239 IA 1986, and there is an important discussion by Lord Reed of whether it is necessary for the company to have '*suffered a loss in the conventional, balance sheet sense'* for a preference-like claim for breach of duty to be brought (at [100] – [111]). There is some disagreement between the judges as to whether directors must take creditors' interests into account before the creditor duty is engaged, with a suggestion in Lady Arden's judgment that directors may need to consider creditors as part of their ordinary duty to promote the success of the company for the benefit of members even though creditors are not specifically listed in s172(1) with which other judges implicitly or explicitly disagree. Several of the judgments discuss the concept of 'economic interest'. There appears to be disagreement as to whether the other directors' duties (notably the duty in s171 to exercise powers for the purposes for which they are conferred) are qualified by s172(3). And there is an important note by Lord Briggs that ,'*It is, in passing, an irony of the present case that the May dividend has been found to have offended section 423 but no claim that it involved for that reason alone a breach of duty by the respondent directors has ever been pursued'* (at [182]).

The views expressed in this Technical Bulletin do not necessarily reflect those of individual members of the Technical Committee, or the members of the Insolvency Lawyers' Association as a whole.

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