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UK Supreme Court Settles Scope of Directors' Duties to Creditors

Judgment of the Supreme Court in BTI 2014 LLC v Sequana SA and others [2022] UKSC 25

By Prateek Swaika, David Hunt, and Juan Pablo Charris

The UK Supreme Court considered the duty of company directors with respect to the interest of creditors pursuant to s.172(3) of the Companies Act 2006. The decision will become the leading authority in proceedings brought against company directors regarding their duties in the context of insolvency.

Directors of UK companies owe a fiduciary duty to act in their company's best interest (understood to mean the best interests of company members as a whole). However, a number of cases have suggested that, in instances of or near insolvency, director's duties extend beyond shareholders to include the interests of creditors instead. This case clarifies the existence and scope of this duty.

Background

In May 2009, the directors of AWA distributed a €135 million dividend to its only shareholder, Sequana SA. The distribution of the dividend set off almost the entirety of a slightly larger debt which Sequana owed to AWA.

At the time that the dividend was paid, AWA was solvent on both a balance sheet and a cash flow basis. However, AWA had long-term pollution-related contingent liabilities of an uncertain amount. In 2018, almost ten years after the dividend had been paid, the contingency materialised and AWA went into insolvent administration.

BTI, as assignee of one of AWA's creditors, claimed that AWA's directors had breached an alleged duty to regard the interests of its creditors and consequently sought the full amount of the dividend from them. BTI was unsuccessful both before the High Court and the Court of Appeal with this claim. In its decision, the Court of Appeal found that, although a creditor interest duty could be engaged short of actual insolvency, it was only triggered "when the directors know or should know that the company is or is likely to become insolvent." Based on the facts of the case, the Court of Appeal concluded that the duty had not become engaged by May 2009 because insolvency was not imminent or probable, even if there was a risk.

BTI appealed to the Supreme Court.

The Supreme Court's Findings

On October 5, 2022, the Supreme Court (Lords Reed, Hodge, Briggs, Kitchen and Lady Arden) unanimously dismissed BTI's appeal. The Judgment is available here. Its starting point is that a creditor duty does exist at common law and is preserved by s.172(3) of the Companies Act 2006.

With respect to the nature of the creditor duty, Lord Briggs, who gave the leading judgment, said that:

> *"prior to the time when liquidation becomes inevitable (…) the creditor duty is a duty to consider creditors' interests, to give them appropriate weight, and to balance them against shareholders' interests where they may conflict. Circumstances may require the directors to treat shareholders' interests as subordinate to those of the creditors (…) This is likely to be a fact sensitive question. Much will depend upon the brightness or otherwise of the light at the end of the tunnel; i.e. upon what the directors reasonably regard as the degree of likelihood that a proposed course of action will lead the company away from threatened insolvency, or back out of actual insolvency. It may well depend upon a realistic appreciation of who, as between creditors and shareholders, then have the most skin in the game: i.e. who risks the greatest damage if the proposed course of action does not succeed"*

Importantly, while this duty is often referred to as a "*creditor duty*," the duty is not freestanding and remains owed to the company, not to the creditors individually or collectively.

Further, the Court held that where an insolvent liquidation or administration is inevitable, the creditors' interests become paramount as its shareholders cease to retain any valuable interest in the company. As to the trigger point at which this duty is engaged, the majority aligned with the Court of Appeal in holding that the duty was not triggered upon there being a "*real risk*" of insolvency. Instead, the duty arises when directors know, or ought to know, their company is insolvent, when insolvency is imminent, or where an insolvent liquidation or administration is probable. A risk of insolvency in the future, albeit real, is insufficient unless it amounts to a probability. Notably, a minority (Lord Reed and Lady Arden) left open the question of whether it is essential that directors know or ought to know whether insolvency is imminent or probable.

Ultimately, although BTI prevailed in obtaining the Court's recognition of a creditor duty in instances of insolvency, the Supreme Court confirmed that, on the facts of this case, the duty was not engaged because AWA was not at imminent or probable risk of insolvency, at the time the dividend was paid.

Way Forward

This judgment is an important development in English company and insolvency law. This is the first decision in which the Supreme Court has addressed that the interest of creditors should be included within the scope of directors' duties in the context of insolvency. In this respect, the decision confirms that the duty only becomes engaged when insolvent liquidation or administration is imminent or probable.

Although company directors' obligation to consider the application of creditor duty will ultimately depend on the facts of each case, this decision provides clarity on the legal framework applicable to directors when making critical financial decisions. It is therefore advisable that directors of distressed companies seek early legal advice to understand the scope of their duties to ensure compliance with the law and to avoid the risk of follow-on litigation, potentially for decades.

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