BTI 2014 LLC (Appellant) v Sequana SA and others (Respondents) [2022] UKSC 25 On appeal from: [2019] EWCA Civ 112

Date:5 October 2022

Justices

Lord Reed (President), Lord Hodge (Deputy President), Lord Briggs, Lady Arden and Lord Kitchin

Background to the Appeal

This appeal raises questions of considerable importance for company law. It provides the first opportunity for the Supreme Court to consider the existence, content and engagement of the so-called "**creditor duty**". That is, the alleged duty of company directors to consider, or to act in accordance with, the interests of the company's creditors when the company becomes insolvent, or when it approaches, or is at real risk of, insolvency. The creditor duty is also known as the "rule in West Mercia" after the leading case of *West Mercia Safetywear v Dodd*.

In May 2009, the directors of a company called AWA caused it to distribute a dividend of €135 million ("the **May dividend**") to its only shareholder, Sequana SA ("**Sequana**"). This extinguished almost the whole of a larger debt which Sequana owed to AWA. The May dividend complied with the statutory scheme regulating the payment of dividends in Part 23 of the Companies Act 2006 ("the **2006 Act**") and with the common law rules on the maintenance of capital. At the time the May dividend was paid, AWA was solvent on both a balance sheet and a commercial (or cash flow) basis. However, it had long-term pollution-related contingent liabilities of an uncertain amount and an insurance portfolio of an uncertain value. There was a real risk that AWA might become insolvent in the future, though insolvency was not imminent, or even probable.

In the event, AWA went into insolvent administration almost ten years later, in October 2018. The appellant, BTI 2014 LLC ("**BTI**"), is the assignee of AWA's claims. BTI sought to recover the amount of the May dividend from AWA's directors. It argued that the directors' decision to distribute the May dividend was taken in breach of the creditor duty because the directors had not considered or acted in the interests of AWA's creditors. Both the High Court and the Court of Appeal rejected the creditor duty claim. In the judgment of the Court of Appeal, the creditor duty did not arise until a company was either actually insolvent, on the brink of insolvency or probably headed for insolvency. Its provisional view was that the creditor duty became paramount as soon as the company became insolvent. Since AWA was not insolvent or on the brink of insolvency in May 2009, BTI's creditor duty claim failed. BTI now appeals to the Supreme Court.

Judgment

The Supreme Court unanimously dismisses BTI's appeal. All members of the Court agree that AWA's directors were not at the relevant time under a duty to consider, or to act in accordance with, the interests of creditors in the circumstances of this appeal. Lord Briggs gives the majority judgment, with which Lord Kitchin agrees. Lord Hodge gives a concurring judgment. Lord Reed and Lady Arden each give judgments which concur in the result for reasons that are broadly similar to those of the majority, but with some differences.

Reasons for the Judgment

Issue 1: Is there a common law creditor duty at all?

Section 172(1) of the 2006 Act 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. It codifies the long-established common law fiduciary duty to act in good faith in the interests of the company, implementing the recommendations of the Steering Group of the Department of Trade and Industry's Company Law Review. The Supreme Court holds that, in certain circumstances, this duty is modified by the common law rule that the company's interests are taken to include the interests of the company's creditors as a whole **[11]**; **[152]**; **[207]**; **[250]**.

Lord Briggs uses "creditor duty" as a convenient label for this modifying rule. However, he agrees with Lord Reed that it is in truth an aspect of the director's duty to the company, rather than a free-standing duty of its own [**205**]. Lord Reed and Lady Arden prefer to describe the modifying rule as "the rule in West Mercia" after the leading case **[11]; [257]**.

All members of the Court agree that the creditor duty should be affirmed for the following reasons. First, the duty is supported by a long line of UK case law (as well as authority from Australia and New Zealand), which began in the mid-1980s **[29]-[36]**; **[43]**; **[152]**; **[207]**; **[387]-[416]**. Second, the majority hold that the duty is affirmed (per Lord Briggs [**153**] and Lord Hodge [**209**]; [**224**]), or its possible existence is preserved (per Lord Reed [69]-[71]; [76] and Lady Arden [**344**]) by section 172(3) of the 2006 Act. This makes the duty under section 172(1) "subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company". Third, the duty has a coherent and principled justification. Creditors always have an economic interest in the company's assets, but the relative importance of that economic interest increases where the company is insolvent or nearing insolvency. In those circumstances, the directors should manage the company's affairs in a way which takes creditors' interests into account and seeks to avoid prejudicing them **[12]**; **[45]**; **[83]**; **[147]-[148]**; **[246]**; **[256]**. For the meaning of insolvency in this context see **[88]**; **[120]** and **[307]-[310]**.

The shareholder authorisation or ratification principle does not prevent the recognition of the creditor duty. Where the directors are under a duty to act in good faith in the interests of the creditors, the shareholders cannot authorise or ratify a transaction which is in breach of that duty **[91]**; **[149]**; **[312]**. This is because there can be no shareholder ratification of a transaction entered into when the company is insolvent, or which would render the company insolvent. There is similarly no conflict between the creditor duty and section 214 of the Insolvency Act 1986 ("the **1986 Act**"), which deals with wrongful trading **[94]**; **[97]**; **[99]**; **[122]**; **[238]**; **[326]**.

Directors owe their duties to the company, rather than directly to shareholders or to creditors. All members of the Court agree that the creditor duty is not a free-standing duty that is owed to creditors **[11]**; **[112]**; **[135]**; **[261]-[277]**.

Issue 2: Can the creditor duty apply to a decision by directors to pay an otherwise lawful dividend?

The Supreme Court holds that the creditor duty can apply to a decision by directors to pay a dividend which is otherwise lawful, for two reasons **[110]**; **[160]-[162]**; **[247(ii)]**; **[342]**. First, Part 23 of the 2006 Act is subject to any rule of law to the contrary (see section 851(1)). Since the creditor duty is part of the common law and is recognised by section 172(3) of the 2006 Act, it is not excluded by Part 23 [**160**]. Second, a decision to pay a dividend that is lawful under Part 23 may still be taken in breach of duty. Part 23 identifies profits available for distribution on a balance sheet basis, but it cannot be the case that directors of a company which is cash flow insolvent (i.e. unable to pay its debts as they fall due) could lawfully distribute a dividend [**161**].

Issue 3: What is the content of the creditor duty?

Where the company is insolvent, or bordering on insolvency, but is not faced with an inevitable insolvent liquidation or administration, the directors should consider the interests of creditors, balancing them against the interests of shareholders where they may conflict. The greater the company's financial difficulties, the more the directors should prioritise the interests of creditors **[81]-[82]**; **[176]-[177]**; **[303]**.

The interests of creditors are the interests of creditors as a general body. The directors are not required to consider the interests of particular creditors in a special position **[48]**; **[247(iv)]**; **[256]**.

Lady Arden holds that the content of the rule in *West Mercia* is not limited to consideration of creditors' interests; the directors are also required not to harm those interests [**288**]. She notes that the progress towards insolvency may not be linear, and that directors should stay informed of the company's financial position **[303]-[304]**.

All members of the Court agree that, where an insolvent liquidation or administration is inevitable, the creditors' interests become paramount as the shareholders cease to retain any valuable interest in the company **[81]**; **[176]-[177]**; **[247(iv)]**; **[291]**; **[306]**. In Lord Briggs' judgment, this happens at the point that section 214 of the 1986 Act also becomes engaged [**176**].

Issue 4: When is the creditor duty engaged? Was it engaged on the facts of this case?

All of the members of the Court agree that the creditor duty was not engaged on the facts of this case. This is because, at the time of the May dividend, AWA was not actually or imminently insolvent, nor was insolvency even probable. The duty does not apply merely because the company was at a real and not remote risk of insolvency **[14]**; **[83]**; **[199]**; **[306]**.

The majority hold that the creditor duty is engaged 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 **[203]**; **[231]**. Lord Reed and Lady Arden agree that the duty applies when the company is insolvent or bordering on insolvency, or when an insolvent liquidation or administration is probable **[88]**; **[279]**. However, they leave open the question of whether it is essential that the directors know or ought to know that this is the case **[90]**; **[281]**.

References in square brackets are to paragraphs in the judgment

Note

This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available online. Decided cases