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THE IMPACT OF *SEQUANA* ON THE DIRECTORS' OBLIGATION TO CONSIDER CREDITOR INTERESTS IN FINANCIALLY DISTRESSED COMPANIES: WAS IT WORTH THE WAIT?

Abstract

In many Commonwealth jurisdictions, including Australia and the United Kingdom ('UK'), it has been established that, as part of their duty to act in the best interests of the company, directors have an obligation to consider the interests of their company's creditors when their company is in some form of financial distress. In October 2022, the UK Supreme Court delivered its long-awaited judgment in *BTI 2014 LLC v Sequana SA* on this issue. This judgment, which was lengthy and wide-ranging, was the first one handed down by the most senior court in the UK on the topic. Undoubtedly, because of the seniority of the Court and the fact that the judgment is wide-ranging, the case will be cited in many subsequent cases in various jurisdictions that have to rule on whether directors are in breach of the obligation. This article analyses the impact of the judgment on the law as it relates to the directors' obligation and asks whether the wait for the judgment was worth it. Does the decision add anything to the law that we have on the obligation, and if so, what? Or does the judgment leave stakeholders still floundering when it comes to the critical issues that have been raised in relation to the obligation?

I Introduction

In many Commonwealth jurisdictions, including Australia and the United Kingdom ('UK'), it has been established that, as part of their duty to act in the best interests of the company, directors have an obligation to consider the interests of their company's creditors when their company is in some form of financial distress.[1] There has been a plethora of cases in both Australia and the UK, and particularly over the past 30 years, that have dealt with this issue, and a

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1 See below Part II.

substantial jurisprudence has developed.[2] However, there continues to be uncertainty in relation to some aspects of the obligation that directors have in respect of creditors. Every time a superior court, in whatever jurisdiction, hears an appeal in relation to a case involving the obligation, there is hope in the legal profession and among those practising as insolvency practitioners that the resultant judgment will clarify the law concerning the obligation.

On 5 October 2022, the UK Supreme Court delivered its long-awaited judgment in *BTI 2014 LLC v Sequana SA* ('*Sequana*')[3] on this issue. One of the justices of the Court said that the decision was momentous for company law.[4] The appeal had been heard by the UK Supreme Court in May 2021 and it is fair to say that corporate and insolvency lawyers as well as insolvency practitioners who act as liquidators and administrators of insolvent companies had been eagerly waiting for the judgment. Some liquidators and administrators had, certainly in the UK, been refraining from instituting proceedings against directors until the Supreme Court's judgment had been handed down. The judgment, which was lengthy and wide-ranging, was the first one handed down by the most senior court in the UK on the topic. Undoubtedly, because of the seniority of the Court and the fact that the judgment is wide-ranging, the case will be cited in many subsequent cases in various jurisdictions that have to rule on whether directors are in breach of the obligation and may have an impact on future decisions in a variety of jurisdictions.

This article analyses *Sequana* and endeavours to assess the impact of the judgment on the law as it relates to the director's obligation and asks whether the wait for it was worth it. Does the decision add anything to the law that we have on the obligation, and if so, in what way? Or does the judgment leave stakeholders still floundering when it comes to the critical issues that have been raised in relation to the obligation?

After providing a short explanation of the background to the obligation, this article explains the facts and discusses how the case arrived before the Supreme Court. Next, the article identifies and examines the main elements of the judgment. The final substantive part of this article reflects on what the judgment means for the law and practice in relation to the obligation to consider creditor interests. The article ends with some concluding remarks.

II Background to the Obligation

The obligation with which we are concerned in this article has its roots in the Australian case of *Walker v Wimborne*,[5] decided in 1976. In this judgment, Mason J said (with Barwick CJ concurring) that the directors of an insolvent company in

2 See below Part II.

3 [2022] 3 WLR 709 ('*Sequana*').

4 Ibid 780 [248] (Lady Arden JSC).

5 (1976) 137 CLR 1 ('*Walker v Wimborne*').

'discharging their duty to the company must take account of the interests of its shareholders and its creditors'.[6] The approach taken by Mason J was followed in the 1980s by other Australian courts as well as those in New Zealand. The best known and perhaps most relevant cases include the New Zealand case of *Nicholson v Permakraft (NZ) Ltd*[7] and the Australian decision of *Kinsela v Russell Kinsela Pty Ltd (in liq)* ('*Kinsela*').[8] The latter case was referred to by Lady Arden JSC in *Sequana* as seminal.[9] *Kinsela* was approved of by many subsequent Australian and Commonwealth cases, including by the English Court of Appeal in the first UK case that considered the obligation in 1988.[10] The obligation was considered in the late 1990s by the Company Law Review Steering Group ('CLRSG'), established by the UK government to engage in a comprehensive examination of UK company law. Ultimately, in its final report, a majority of the CLRSG advocated for the inclusion of reference to the obligation in any new legislation that was enacted.[11]

The case law has, often without comment as to its genesis, accepted the existence of the obligation. The UK Supreme Court in *Sequana* unequivocally acknowledged the obligation.[12] There has been no doubt cast in any case on the fact that the obligation is triggered when a company is insolvent.[13] Many cases have also stated that the obligation arises when a company is in a state short of insolvency but in some kind of financial distress.[14] There has been a host of ways that this has been expressed, particularly in Australia. The trigger for the obligation has been described as where the company is 'near-insolvent',[15] 'approaching insolvency',[16] 'in the face of an

6 Ibid 7.

7 [1985] 1 NZLR 242 ('*Nicholson*').

8 (1986) 4 NSWLR 722 ('*Kinsela*').

9 *Sequana* (n 3) 791 [288].

10 *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

11 Company Law Review Steering Group, *Modern Company Law: For a Competitive Economy* (Final Report, June 2001) vol 1, xvii.

12 *Sequana* (n 3) 734 [76], 744 [111] (Lord Reed PSC), 752 [138] (Lord Briggs JSC), 779–80 [247] (Lord Hodge DPSC), 780 [248] (Lady Arden JSC).

13 See, eg: *Kinsela* (n 8); *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] BCC 885 ('*Colin Gwyer*'); *BTI 2014 LLC v Sequana SA* [2017] Bus LR 82 ('*Sequana High Court*').

14 See: Andrew Keay, 'The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered?' (2001) 25(2) *Melbourne University Law Review* 315; Rosemary Teele Langford and Ian Ramsay, 'The Contours and Content of the "Creditors' Interests Duty"' (2021) 21(1) *Journal of Corporate Law Studies* 85.

15 *Nicholson* (n 7) 249 (Cooke J). See also: *Re New World Alliance (rec and mgr apptd); Sycotex Pty Ltd v Baseler [No 2]* (1994) 51 FCR 425, 444 (Gummow J) ('*Re New World Alliance*'); *Liquidator of Wendy Fair (Heritage) Ltd v Hobday* [2006] EWHC 5803 (Ch), [66] (Peter Smith J).

16 *Geneva Finance Ltd (rec and mgr apptd) v Resource & Industry Ltd* (2002) 169 FLR 152, 164 [26] (Heenan J) ('*Geneva Finance*').

imminent insolvency',[17] 'facing insolvency',[18] 'borderline solvency',[19] 'on the verge of insolvency',[20] in some sort of 'dangerous financial position'[21] or is financially unstable.[22] In *Re HLC Environmental Projects Ltd (in liq)*[23] John Randall QC (sitting as a deputy High Court judge) said that he did not detect any difference in principle between the various expressions that had been used by a range of courts.[24] In *Kalls Enterprises Pty Ltd (in liq) v Baloglow*,[25] Giles JA, in giving the leading judgment in the New South Wales Court of Appeal, identified a trigger that was to become very important later on in the UK. His Honour said that for the obligation to arise the company need not be insolvent at the time; the directors must consider creditor interests if 'there is a real and not remote risk that they will be prejudiced' by any dealing or action the directors are contemplating.[26] Notwithstanding being robustly argued for by the claimant in the *Sequana* litigation, it was rejected at all levels, that is, before the English High Court, the English Court of Appeal and the UK Supreme Court.[27] The Court of Appeal declined to approve of any of the existing formulae.[28] Lord Justice David Richards (with Longmore and Henderson LJJ concurring) held that the obligation arises 'when the directors know or should know that the company is or is likely to become insolvent'.[29] However, on appeal, the UK Supreme Court did not approve of this approach and maintained that the trigger is when the company 'is insolvent or bordering on insolvency',[30] or 'insolvent liquidation or administration is probable'.[31] Lord Reed PSC in that case felt that the 'bordering on insolvency' trigger was to the same effect as many of the other formulae identified in other cases to indicate the triggering of the creditor duty prior to insolvency.[32]

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17 Ibid 161 [20].

18 *Kalls Enterprises Pty Ltd (in liq) v Baloglow* (2007) 63 ACSR 557, 589 [162] (Giles JA) ('*Kalls Enterprises*'), cited in *Fitz Jersey Pty Ltd v Atlas Construction Group Pty Ltd (in liq)* [2021] NSWSC 1692, [1106] (Stevenson J).

19 *Eastford Ltd v Gillespie* [2011] SC 501, 511 [15] (Lord Hardie for the Court).

20 *Colin Gwyer* (n 13) 906 [74].

21 *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218, 228.

22 See *Linton v Telnet Pty Ltd* (1999) 30 ACSR 465, 478 (Giles JA).

23 [2013] EWHC 2876 (Ch) ('*Re HLC Environmental Projects*').

24 Ibid [89].

25 *Kalls Enterprises* (n 18).

26 Ibid 589 [162]. In the same paragraph his Honour also said that the obligation is triggered when the company is facing insolvency.

27 *Sequana High Court* (n 13); *BTI 2014 LLC v Sequana SA* [2019] Bus LR 2178 ('*Sequana Court of Appeal*'); *Sequana* (n 3).

28 *Sequana Court of Appeal* (n 27) 2232 [213]–[216] (David Richards LJ).

29 Ibid 2233 [220].

30 *Sequana* (n 3) 727–8 [51], 737 [88] (Lord Reed PSC), 768–9 [207], 779–80 [247] (Lord Hodge DPSC), 788–9 [279] (Lady Arden JSC).

31 Ibid 788–9 [279] (Lady Arden JSC).

32 Ibid 737 [88].

When the obligation applies, there is anecdotal evidence that there has been some uncertainty as to what the directors must do.[33] Some English[34] and most Australian[35] cases have said, when the company is in a state close to insolvency or in financial distress, that the director must take into account the interests of the shareholders and the creditors, something that is consistent with the comments of Mason J in *Walker v Wimborne*.[36] However, the vast majority of English cases at first instance, as well as the Court of Appeal in *BTI 2014 LLC v Sequana SA*,[37] have said that when the company is insolvent the interests of the creditors are paramount.[38] The judges in the majority of English cases have also opined that the creditors' interests are to be regarded as paramount when the company is not insolvent but nearing it.[39] However, the Supreme Court in *Sequana* rejected this approach and said that until a company is insolvent, or insolvent liquidation or administration is inevitable, directors must consider the interests of shareholders as well as creditors.[40] According to Lord Briggs JSC (with whom Lord Hodge DPSC and Lord Kitchin JSC agreed), creditor interests in fact *may* not even be paramount in insolvency.[41] There is clear Australian obiter dicta to support the view that creditors' interests are not paramount after the obligation is triggered but before a company becomes insolvent. According to Australian authority, even when a company is insolvent, the creditors' interests may not be paramount.[42]

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33 Uncertainty is noted in *BCI Finances Pty Ltd (in liq) v Binetter [No 4]* (2016) 348 ALR 227, 276 [277] (Gleeson J).

34 *Re MDA Investment Management Ltd; Whalley v Doney* [2005] BCC 783, 805 [70] (Park J); *Goldtrail Travel Ltd (in liq) v Aydin* [2014] EWHC 1587 (Ch), [115].

35 See, eg, *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]* (2009) 39 WAR 1, 544 [4436] (Owen J).

36 *Walker v Wimborne* (n 5).

37 *Sequana Court of Appeal* (n 27) 2233 [222] (David Richards LJ).

38 See, eg: *Colin Gwyer* (n 13) 906 [74]; *Re Capitol Films Ltd (in administration)* [2010] EWHC 2240 (Ch), [49] ('*Capitol Films*'); *Roberts v Frohlich* [2012] BCC 407, 433 [85]; *Re HLC Environmental Projects* (n 23) [89], [92]; *Re Bowe Watts Clargo Ltd (in liq)* [2017] EWHC 7879 (Ch); *Ball v Hughes* [2018] BCC 196, 206 [64] ('*Ball*'). The comments of Lord Toulson and Lord Hodge JJSC in *Bilta (UK) Ltd (in liq) v Nazir [No 2]* [2015] 2 WLR 1168 ('*Bilta*') suggest that they acceded to this: at 1212 [126]. Cf Kristin van Zwieten, 'Director Liability in Insolvency and its Vicinity' (2018) 38(2) *Oxford Journal of Legal Studies* 382, 388.

39 See, eg: *Colin Gwyer* (n 13) 906 [74]; *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [165]; *Re HLC Environmental Projects* (n 23) [192]; *Ball* (n 38) 204 [64]. See also the discussion in Langford and Ramsay (n 14).

40 *Sequana* (n 3) 716 [11], 727 [50], 734 [77] (Lord Reed PSC), 758 [164], 761 [172], 765–6 [190] (Lord Briggs JSC), 779–80 [247] (Lord Hodge DPSC), 792 [290] (Lady Arden JSC).

41 Ibid 761–2 [172]–[175], 766–7 [190].

42 See, eg, *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* (2012) 44 WAR 1, 366 [2046] (Drummond AJA) ('*Bell*').

While some have argued that the dictum of Mason J in *Walker v Wimborne*[43] should be limited to corporate groups,[44] the jurisprudence provides for a much wider ambit and it has now become so well established that it has got to the point where it will not be reversed in any significant way. As Drummond AJA said in the appeal in *Westpac Banking Corporation v Bell Group Ltd (in liq) [No 3]* ('*Bell*'),[45] it is now firmly entrenched in company law jurisprudence in Australia, New Zealand and the UK, with the result that in numerous cases, courts have found directors liable for a breach of the duty to properly consider the interests of creditors.[46] Nevertheless, Drummond AJA made the point in *Bell* that the doctrine is still being developed.[47] This was also the view of David Richards LJ in his leading judgment of the English Court of Appeal in *BTI 2014 LLC v Sequana SA*[48] and that of the judges in the Supreme Court in *Sequana*.[49]

In completing this background to the obligation, it must be emphasised that the obligation does not provide that directors owe a duty to creditors.[50] The duty is owed to the company to act in its best interests but requires directors to consider the interests of creditors in discharging the duty. If there is any breach of the duty, the company or a person acting on behalf of it, usually a liquidator, must bring any legal proceedings, as creditors are not able to do so. The UK Supreme Court in *Sequana* regarded the obligation as a qualification[51] or modification[52] to the duty contained in s 172(1) of the *Companies Act 2006* (UK), that is, the duty to promote the success of the company for the members, which is the successor to the duty to act in the best interests of the company as a whole.

Finally, it should be noted that the obligation has been recognised legislatively in both the UK, in the form of s 172(3) of the *Companies Act 2006* (UK), as well as in Ireland, in the form of ss 224(A) and 228 of the *Companies Act 2014* (Ireland).

43 *Walker v Wimborne* (n 5) 7.

44 See Justice KM Hayne AC, 'Directors' Duties and a Company's Creditors' (2014) 38(2) *Melbourne University Law Review* 795, 800.

45 *Bell* (n 42).

46 Ibid 365–6 [2043].

47 Ibid 364–5 [2039].

48 *Sequana Court of Appeal* (n 27).

49 *Sequana* (n 3) 715 [4], 717 [15] (Lord Reed PSC), 757 [153], 764–5 [186] (Lord Briggs JSC).

50 See, eg: *Yukong Line Ltd of Korea v Rendsburg Investments Corporation of Libera [No 2]* [1998] 1 WLR 294; *Spies v The Queen* (2000) 201 CLR 603, 636–7 [95] (Gaudron, McHugh, Gummow and Hayne JJ) ('*Spies*'); *Bilta* (n 38) 1212 [125], [126] (Lord Toulson and Lord Hodge JJSC); *Sequana* (n 3) 716 [11] (Lord Reed PSC), 768 [205] (Lord Briggs JSC).

51 *Sequana* (n 3) 773–4 [225] (Lord Briggs JSC), 783 [258], 785 [265] (Lady Arden JSC).

52 Ibid 733 [74], 739 [96] (Lord Reed PSC), 782 [252] (Lady Arden JSC).

III The Background to *Sequana*

In 1978, Appleton Papers Inc ('API'), a wholly-owned subsidiary of BAT Industries plc ('BAT'), acquired two paper coating businesses operating in Wisconsin, United States of America.[53] Under the terms of the business acquisition, API took over the liabilities of the seller, National Cash Register Co ('NCR'), including certain environmental liabilities, and BAT agreed to indemnify NCR against any failure by API to meet those liabilities.[54] In 1989, BAT established Wiggins Teape Appleton plc ('WTA') as the holding company of API.[55] The following year, WTA was demerged from BAT and later merged with a French paper manufacturer, changing its name to Arjo Wiggins Appleton plc ('AWA').[56] The paper businesses acquired by BAT had been responsible for extensive pollution.[57] Commencing in the 1990s, claims were notified against, among others, NCR and API. The claims related to clean-up costs and natural resources damages resulting from the pollution.[58] Under an agreement made in 1998 between NCR, API and BAT, it was agreed that liabilities of the parties related to the pollution would be shared up to a total of $75 million as to 45% by NCR and as to 55% by API and BAT.[59] In 2000, AWA was acquired by Sequana SA.[60] In 2001, API was sold by AWA. As part of the sale, AWA indirectly indemnified API against all liabilities relating to the pollution.[61] API assigned to AWA its rights against third parties, including rights under insurance policies that had been taken out by BAT between 1978 and 1986 to cover any liability for the pollution.[62] Through a subsidiary, AWA purchased from an insurer, AIG a guaranteed investment contract, to provide funds to pay for all aspects of the liability for the pollution.[63]

Subsequent to the sale of API, AWA ceased to be a trading company.[64] The proceeds of sale of its businesses and other receipts were lent over the years to Sequana SA.[65] Thereafter, Sequana SA and the directors of AWA explored ways of reducing the debt of Sequana SA.[66] At that time AWA's only significant obligations were in relation to its contingent indemnity liabilities.[67] A provision of €62.8 million was made against

53 *Sequana High Court* (n 13) 91 [8]–[9].

54 Ibid 91 [9].

55 *Sequana Court of Appeal* (n 27) 2183 [9].

56 *Sequana High Court* (n 13) 91 [11]–[12].

57 *Sequana Court of Appeal* (n 27) 2183 [10].

58 Ibid 2183 [10].

59 Ibid 2183 [11].

60 *Sequana High Court* (n 13) 91–2 [14].

61 Ibid.

62 Ibid.

63 Ibid 92 [15].

64 Ibid 92 [16].

65 Ibid.

66 *Sequana Court of Appeal* (n 27) 2184 [14].

67 Ibid.

its contingent liabilities in AWA's interim accounts approved in December 2008.[68] The provision represented the difference between the amount recoverable under the insurance that it had taken out in relation to any liability relating to the pollution and the directors' best estimate of the liability.[69] To the extent that the debt of Sequana SA exceeded the provision, 'it represented net assets in the accounts that were, on the face of the accounts, surplus to AWA's requirements'.[70] The net assets shown in the interim accounts amounted to €517 million.[71] Sequana SA and the directors of AWA decided that a dividend of €443 million should be paid to Sequana SA.[72] In order to achieve this, the board of AWA resolved to make a capital reduction.[73] The board of AWA resolved on 17 December 2008 to pay a dividend by way of set-off against the debt owed to AWA by Sequana SA, reducing the debt to €142.5 million.[74] Following these steps, AWA's paid-up share capital was €1 million and its distributable reserves, as shown in its final accounts for the year ended 31 December 2008, were €137 million.[75]

In 2009, the insurance policy was deemed sufficient to cover the best estimate of the liability for the pollution and, therefore, it was not necessary to include a provision in the accounts for the liability.[76] An audit provided AWA's accounts with 'an unqualified certificate that they gave a true and fair view'.[77] The final accounts for 2008 showed distributable reserves of €137 million.[78] On 18 May 2009, the board of AWA resolved to pay an interim dividend of €135,181,358 by way of set-off against what Sequana SA owed to AWA, reducing it to about €3.1 million.[79] The dividend was paid in contemplation of the sale by Sequana SA of AWA. At the time of the sale of AWA, Sequana SA was no longer exposed to the risk that its debt to AWA would be called to fund indemnity payments.[80]

Later, AWA, acting through its new board, challenged both of the dividends made to Sequana and in each case on several bases. The two most important ones were, first, the payment of the dividends fell within s 423 of the *Insolvency Act 1986* (UK), which is broadly equivalent to s 121 of the *Bankruptcy Act 1966* (Cth) and s 588FE(5) of the *Corporations Act 2001* (Cth) and is a successor to the *Fraudulent Conveyances*

68 Ibid 2184 [15].

69 Ibid.

70 Ibid.

71 Ibid.

72 Ibid 2184 [16].

73 Ibid.

74 Ibid.

75 Ibid.

76 Ibid 2184 [17].

77 Ibid.

78 Ibid 2185 [18].

79 Ibid.

80 Ibid 2185 [20].

Act 1571, 13 Eliz 1, c 5 and meant that Sequana SA had to compensate AWA.[81] Alternatively, and the claim with which this article is concerned, the dividends were paid in breach of the duty of the directors of AWA to have regard to the interests of its creditors on the basis that the directors had a duty to consider the interests of creditors when they paid the dividend, because at that point there was a real and not remote risk of AWA becoming insolvent.[82] The claims were originally brought by AWA, but it was replaced as claimant by BTI to which AWA had assigned the claims. BTI was a corporate vehicle established by BAT for this very purpose. BAT brought the claim under s 423 in its own capacity as a potential creditor of AWA and thus as a 'victim' of the payment of the dividends.[83]

At first instance Rose J dismissed the claim that the former AWA directors failed to take account of the interests of AWA's creditors in paying the dividends but found against Sequana SA on the s 423 claim.[84] Sequana SA appealed against the judgment given against it under s 423, and BTI appealed against the dismissal of the claim, that the directors were not liable for breach of duty, arguing that directors had a duty to take into account creditors' interests when there was a real as opposed to a remote, risk of insolvency. The Court of Appeal dismissed all appeals.[85] Importantly for our purposes, David Richards LJ, with whom Longmore and Henderson LJJ concurred, rejected the argument that the obligation was triggered where there was a real, as opposed to a remote, risk of insolvency as it would not be appropriate, in the light of the policy considerations and other provisions of the *Companies Act 2006* (UK) (thinking particularly of s 172(3)), for the courts to introduce such a test as a development of the common law.[86] His Lordship held that the obligation arose when the directors knew or should have known that the company was or was likely to become insolvent.[87]

BTI appealed on the decision to accede to the argument concerning the breach of duty claim. The appeal in the Supreme Court was heard by Lord Reed PSC, Lord Hodge DPSC, Lords Briggs and Kitchen JJSC and Lady Arden JSC. All of the Supreme Court justices gave a separate judgment save for Lord Kitchin JSC, who concurred with the judgment of Lord Briggs JSC. Although his Lordship wrote a separate judgment, Lord Hodge DPSC agreed with Lord Briggs JSC.[88] The judgment was very lengthy. While there were differences in some areas, all justices agreed that the appeal should be dismissed. The Court made a number of comments relating to the obligation, but members of the Court felt that many of these comments should

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81 See ibid 2182 [1]–[4].

82 Ibid 2182 [1].

83 Ibid 2182 [3].

84 Ibid 220–1 [526]–[527].

85 *Sequana Court of Appeal* (n 27) 2236 [237] (David Richards LJ, Henderson LJ agreeing at [238], Longmore LJ agreeing at [239]).

86 Ibid 2227–8 [192]–[195].

87 Ibid 2228 [195],

88 *Sequana* (n 3) 768 [207].

be regarded as provisional as there was no need for the Court to provide a final decision.[89] The ratio of the case is relatively narrow and many of the comments of the Court are, therefore, obiter.

IV The Main Points Decided in *Sequana*

The judgments of the justices in *Sequana* were quite wide-ranging and covered matters that were not necessary to deal with in the appeal before them. Obviously, they felt, especially given the submissions of counsel, that this was an opportunity to make pronouncements on several issues that are related to the obligation. There are a number of points made by the Court that are of interest. Nevertheless, it is submitted that there are four elements of the judgments given by the justices that warrant particular emphasis and consideration in addressing the aim of this article. Arguably, they encompass the primary comments of the justices. We will return to some of the points made in this Part, in Part V below.

A *Acknowledgement of the Existence of the Obligation*

While the obligation has been applied in case law for over 40 years and might well be regarded as established, in arguments to the Supreme Court, the respondent to the appeal argued that the obligation should not apply in UK law. This argument was completely rejected, and all of the justices accepted that the obligation was part of UK law.[90] What is more, the Court said that the obligation had a sound legal basis,[91] thus it was not a matter of the Court grudgingly accepting the obligation's existence because it had been applied for more than 40 years and could not now be overturned.

Lord Briggs JSC said that undoubtedly the obligation's existence rather than its denial was more consistent with both company law, as reflected in the *Companies Act 2006* (UK), and with insolvency law as largely codified in the *Insolvency Act 1986* (UK).[92] It was accepted that the obligation is 'a rule of law' within s 172(3) of the *Companies Act 2006* (UK),[93] and that s 172(3) expressly preserved the existing common law rule requiring directors to consider the interests of creditors.[94]

89 See, eg, ibid 715 [4], 734 [78] (Lord Reed PSC).

90 Ibid 734 [76], 744 [111] (Lord Reed PSC), 752 [138] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed), 779 [247] (Lord Hodge DPSC), 780 [248] (Lady Arden JSC).

91 Ibid 734 [76] (Lord Reed PSC), 752 [138] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed), 775 [228] (Lord Hodge DPSC).

92 Ibid 756 [151].

93 Ibid 732 [68]–[69].

94 Ibid 717 [13], 732–3 [72], 733 [73], 740 [99] (Lord Reed PSC), 756 [152], 758 [160] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed), 777 [237] (Lord Hodge DPSC), 782 [252], 784 [262], 816 [386] (Lady Arden JSC). A majority of the justices of the Supreme Court in *Bilta* (n 38) had earlier taken the same view: at 1207–8 [104] (Lord Sumption JSC), 1212 [123]–[124] (Lord Toulson and Lord Hodge JJSC).

The need for the obligation was explained in *Sequana* by Lord Hodge DPSC when his Lordship said:

> I am not persuaded that the existing law without the directors' fiduciary duty to the company to have proper regard to the interests of its creditors covers the field adequately where there is a significant conflict between the interests of the shareholders and the interests of the company's creditors when it is insolvent or bordering on insolvency.[95]

His Lordship had said earlier in his judgment that if the Court rejected the obligation's existence

> it would be going against the recognition by Parliament of the existence of the common law duty to creditors and its expectation that the courts will develop the law in this area. It would also be creating incoherence between our company law and our law of corporate insolvency and would place directors in a position in which their duties and their personal interest were in conflict.[96]

Some arguments had been espoused over the years to the effect that the obligation was not necessary when one takes into account the many provisions providing for the avoidance of transactions occurring before administration or liquidation and establishing liability in insolvency, including wrongful trading (equivalent in some ways to insolvent trading in Australia).[97] Lady Arden JSC scotched that argument and said that there was a need for the obligation.[98]

While the justices acknowledged the existence of the obligation, they emphasised that the obligation did not constitute a self-standing or standalone duty.[99] Lord Reed PSC said that the effect of the obligation is

> to preserve the directors' duty to act in the interests of the company, but to modify the sense of the latter expression so that, where the rule applies, the interests of the company are no longer regarded as solely those of its shareholders but are understood as including those of its creditors as a whole.[100]

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95 *Sequana* (n 3) 778 [242].

96 Ibid 775–6 [232].

97 See, eg: LS Sealy, 'Directors' Duties: An Unnecessary Gloss' (1988) 47(2) *Cambridge Law Journal* 175, 177; LS Sealy, 'Personal Liability of Directors and Officers for Debts of Insolvent Corporations: A Jurisdictional Perspective (England)' in Jacob S Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press, 1994) 488; Peter Watts, 'Why as a Matter of English-Law Principle Directors do not Owe a Duty of Loyalty to Creditors upon Insolvency' [2021] (2) *Journal of Business Law* 103.

98 *Sequana* (n 3) 783 [258].

99 Ibid 768 [205] (Lord Briggs JSC), 784 [260], 785 [265], 788 [277] (Lady Arden JSC).

100 Ibid 734 [79].

The position taken by the Supreme Court accords with the views expressed in *Spies v The Queen*[101] where the High Court of Australia made the same point. Lady Arden JSC said in relation to the notion that the obligation constituted a self-standing duty that

> [i]t would be very curious to have a self-standing duty in relation to creditors obliging the directors to promote the success of the company for the benefit of creditors if the remedies were only as described in the preceding paragraph. Moreover, if there is an independent self-standing duty to creditors, there is a governance issue: the directors can act without being made accountable for the way in which they perform it until liquidation.[102]

While her Ladyship is perfectly correct in saying this, the fact of the matter is that if there is accountability to shareholders, they are likely to do nothing if the directors do breach the obligation to consider creditor interests and thus the impact of the obligation is otiose until an officeholder is appointed.

Of some note is the fact that the Court said that the obligation exists even in relation to when the directors are considering the company entering into lawful transactions.[103]

Although the Supreme Court did not consider the obligation as a duty, the justices referred to it as 'the creditor duty'.[104]

B *The Trigger for the Obligation*

The issue of when the obligation arises has been troublesome ever since the time when the obligation was first propounded by courts. Lord Justice David Richards in the Court of Appeal in *BTI 2014 LLC v Sequana SA* made the following astute observation: 'The precise moment at which a company becomes insolvent is often difficult to pinpoint. Insolvency may occur suddenly but equally the descent into insolvency may be more gradual.'[105]

The appellant's leading ground of appeal involved this issue. The appellant argued that the obligation was triggered if there was a real, as opposed to a remote, risk of insolvency of the company. This was unequivocally rejected by the justices, as it had been in the courts below. Therefore, this cannot be the trigger for the obligation as far as the UK is concerned, as clearly the Court's rejection of the argument formed part of the ratio of the case and so is binding on all UK courts. Where this leaves Australian courts is discussed later.

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101 *Spies* (n 50) 635–7 [93]–[95] (Gaudron, McHugh, Gummow and Hayne JJ).

102 *Sequana* (n 3) 786 [268].

103 Ibid 758 [162] (Lord Briggs JSC), 779–80 [247] (Lord Hodge DPSC).

104 See, eg, ibid 739 [95] (Lord Reed PSC), 744 [112] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed).

105 *Sequana Court of Appeal* (n 27) 2233 [218].

Insolvency has always been regarded as a trigger for the obligation, going back to the time of the seminal judgment of Mason J in *Walker v Wimborne*. The Court of Appeal in *Sequana* certainly accepted it as a trigger and the Supreme Court agreed,[106] although Lord Briggs JSC favoured a more restrictive approach, saying that insolvency could only be a trigger where insolvent liquidation or administration is probable and there is no light at the end of the tunnel for the company.[107] The reason for saying this is that companies can go in and out of insolvency. What does insolvency mean? Lord Reed PSC stated in *Sequana* that argument was not heard as to what did it mean in the context of the obligation, but his Lordship expressed a provisional view that insolvency for the purposes of the obligation meant cash flow or balance sheet insolvency and, showing signs of agreeing with Lord Briggs JSC, temporary commercial insolvency should be excluded.[108] Lady Arden JSC agreed with Lord Reed PSC on this point. In this context her Ladyship said that this meant, in relation to these tests, that the directors should have regard to liabilities which they can foresee will arise in the reasonably near future.[109] Lady Arden JSC opined that the cash flow and balance sheet tests should be the starting point in considering whether a company was insolvent, but they should be 'applied with the degree of flexibility appropriate to the rationale and context of the rule'.[110] Unlike in Australia where only the cash flow test is provided as the test for insolvency,[111] the UK provides in ss 123(1)(e) and 123(2) of the *Insolvency Act 1986* (UK), both the cash flow and balance sheet tests respectively.

The main area of debate has always been: does the obligation arise before insolvency and, if so, at what point? It is evident from a survey of the cases in Australia and the UK that all agree that the obligation may arise before insolvency, but there has been a lack of precision in expressing it. As mentioned earlier, there has been a number of formulae devised for expressing when, before insolvency, the obligation arises. It is not within the scope of the article to discuss them. Many of the formulae perceive that the obligation arises when the company is close to, near to or verging on insolvency and others merely refer to the company being in some sort of financial distress. In the UK Court of Appeal decision in *BTI 2014 LLC v Sequana SA*, David Richards LJ observed that judges had shied away from a single form of words in identifying the trigger, and they had chosen instead to employ a variety of expressions.[112] His Lordship declined to give his imprimatur to any of the existing formulae and was critical of many of them. His Lordship said that some of the descriptions considered conveyed something less than insolvency, but he felt that they were too

106 *Sequana* (n 3) 737 [90] (Lord Reed PSC), 768 [203] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed).

107 Ibid 758–9 [164], 762 [176].

108 Ibid 737 [88].

109 Ibid 795–6 [308].

110 Ibid 795 [308].

111 See *Corporations Act 2001* (Cth) s 95A.

112 *Sequana Court of Appeal* (n 27) 2232 [216].

vague to serve as a useful test for determining when the obligation arose.[113] It will be recalled that in the Supreme Court in *Sequana*, the appellant sought, as it had in earlier hearings, to argue that the obligation arose if there was a real, as opposed to a remote, risk of insolvency of the company. Lord Briggs JSC said that the test argued for in the case by the appellant was too remote from the event which changes a creditor's prospective entitlement into an actual one.[114] There are several Australian cases which have accepted this as a trigger[115] and so the opinion of the Court in *Sequana* diverges from the views of several Australian courts in this aspect. As noted earlier, the argument of the appellant had been submitted at all levels in the proceedings and it had been rejected in every Court.

Three of the justices in *Sequana*, Lord Reed PSC, Lord Hodge DPSC and Lady Arden JSC, referred to the trigger as being when a company is bordering on insolvency,[116] a point previously recognised by Lord Toulson and Lord Hodge JJSC in *Bilta (UK) Ltd (in liq) v Nazir*.[117] However, Lord Briggs JSC did not refer to the obligation being triggered when a company is bordering on insolvency. His Lordship said:

> I would prefer a formulation in which either imminent insolvency (ie an insolvency which directors know or ought to know is just round the corner and going to happen) or the probability of an insolvent liquidation (or administration) about which the directors know or ought to know, are sufficient triggers for the engagement of the creditor duty.[118]

Thus, Lord Briggs JSC favoured imminent insolvency as a trigger, and in his Lordship's judgment, Lord Reed PSC while also identifying 'bordering on insolvency' as the point when the obligation occurred, seemed to agree with imminent insolvency being a trigger.[119]

A trigger that was mentioned in the above quotation from Lord Briggs JSC's judgment, and which has never been identified previously, was accepted by all of

113 Ibid 2232 [213].

114 *Sequana* (n 3) 766 [193].

115 See, eg: *Kalls Enterprises* (n 18) 589 [162] (Giles JA); *Termite Resources NL (in liq) v Meadows* (2019) 370 ALR 191, 231 [202] (White J); *Re IW4U Pty Ltd (in liq)* (2021) 150 ACSR 146, 153 [31] (Gleeson J); *ACN 152 546 453 Pty Ltd (in liq)* [2022] NSWSC 974, [83] (Williams J); *Re Bryve Resources Pty Ltd* (2022) 163 ACSR 310, 324 [73] (Williams J).

116 *Sequana* (n 3) 717 [12], 737 [88] (Lord Reed PSC), 768–9 [207], 779 [246], 779–80 [247] (Lord Hodge DPSC), 789–90 [279] (Lady Arden JSC).

117 *Bilta* (n 38) 1212 [123]–[124].

118 *Sequana* (n 3) 768 [203].

119 Ibid 739–40 [96], 741 [101].

the justices in *Sequana* and it is when insolvent liquidation or administration of a company is probable.[120]

Thus, we find that the justices did not plump for one trigger, but there could be more than one, and it can arise before the advent of insolvency.

C *The Content of the Obligation*

Where the obligation is triggered, what are directors to do? The case law often refers to the need for directors to consider the interests of the creditors. That remains the case given what was said by the Supreme Court, but a comment of Lord Briggs JSC is really important for understanding what this means for directors in the field. His Lordship said:

> There is a large difference between a duty merely to consider the interests of creditors as a class of potential stakeholders and a duty to act in the interests of that class. The former assumes a wide discretion as to the weight (if any) to be given to those interests, in what may be a task of balancing them against the potentially conflicting interests of another class, such as shareholders. The latter suggests that the creditors' interests predominate, if in conflict with the interests of another class, a duty sometimes described as treating the creditors' interests as paramount.[121]

In recent times there has tended to be a difference between the UK courts and the Australian courts on what directors are to do when the obligation is triggered. All are agreed that prior to the trigger occurring the directors must act in the best interests of the company and this means considering the interests of shareholders. However, on the obligation arising the directors must consider the interests of creditors. Does this mean that the shareholders' interests fall out of the picture or do directors have to consider the interests of both shareholders and creditors? The vast majority of English cases at first instance[122] and the Court of Appeal in *Sequana*[123] took the approach that the creditors' interests were paramount when a company was insolvent. While more cases at first instance took the view that where the company was not insolvent, but the obligation had arisen, directors had to consider both shareholder and creditor interests, the majority still favoured the paramountcy of creditors' interests just as when a company was insolvent. The position in Australia has generally been that both creditor and shareholder interests should be considered whatever the financial state of the company (if the obligation has been triggered),

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120 Ibid 737 [90], 739–40 [96] (Lord Reed PSC), 768 [203] (Lord Briggs JSC, with whom Lord Kitchin JSC agreed), 768–9 [207] (Lord Hodge DPSC), 788–9 [279] (Lady Arden JSC).

121 Ibid 746 [118].

122 See, eg: *Re Pantone 485 Ltd* [2002] 1 BCLC 266, [69]; *Colin Gwyer* (n 13) [74]; *Capitol Films* (n 38) [49]; *Re Oxford Pharmaceuticals Ltd* [2009] EWHC 1753 (Ch), [92]; *Roberts v Frohlich* [2011] EWHC 257 (Ch), [85]; *Re HLC Environmental Projects* (n 23) [92].

123 *Sequana Court of Appeal* (n 27).

although the closer a company got to insolvency there was justification for placing greater weight on creditor interests.

The Supreme Court in *Sequana* expressed a view that was closer to the position taken in Australia rather than that espoused in the majority of UK courts. The justices all seemed to say that the interests of both creditors and shareholders must be considered by directors and the closer a company gets to insolvency, the more weight should be given to creditors because it was they who began to assume the greater risk and had the greater economic interest. The relative weight that is placed on each might be determined by a sliding scale, that is, as a company's financial becomes more and more dire and the closer to insolvent liquidation or administration the company gets, the greater concern must be for creditor interests and more weight should be given to those creditor interests. This seems to mean that a balancing exercise must be undertaken in respect of the interests. In *Sequana* Lord Reed PSC said that where there is a conflict between the interests of the creditors and the shareholders, the balancing should reflect their respective weight in the light of the gravity of the company's financial difficulties.[124] This appears to chime with some of the comments of Owen J in *Bell Group Ltd (in liq) v Westpac Banking Corporation [No 9]*,[125] where his Honour seemed to envisage some form of balancing and also appeared to suggest that the balancing that occurs should very much depend on the company's circumstances at the time of any decision-making and when one assesses whether the directors have complied with the obligation and the circumstances should dictate what weight one places on the respective interests.

The justices accepted that paramountcy of creditors' interests could occur, but as to when the justices did not speak with a consistent voice. Lord Reed PSC said that the interests of creditors acquire a discrete significance from those of shareholders, and require separate consideration, once the company's insolvency is imminent or its insolvent liquidation or administration becomes probable.[126] Earlier his Lordship had said that it is only where an insolvent liquidation or administration is unavoidable that the shareholders can be said to have no remaining interest in the company.[127] Lord Briggs JSC was, arguably, more restrictive on this issue. His Lordship said that practical common sense pointed strongly against a duty to treat creditors' interests as paramount at the onset of insolvency for it might only be temporary insolvency. His Lordship said that it is when an insolvent liquidation or administration is inevitable the directors must treat the interests of the creditors as paramount.[128] Lord Briggs JSC rejected insolvency, either balance sheet or cash flow, of itself as advancing the status of creditors beyond being contingent main stakeholders and this remained until liquidation eventuates rather than insolvency. His Lordship went on to say that if there is 'light at the end of the tunnel', the contingency may never occur. The reason for the existence of the obligation did

124 *Sequana* (n 3) 735 [81], 740–1 [96].

125 (2008) 39 WAR 1, 545 [4440].

126 *Sequana* (n 3) 740–1 [96].

127 Ibid 727 [50].

128 Ibid 761 [173].

not go so far, in the view of the judge, as to render creditors' interests necessarily paramount upon insolvency.[129] Lord Briggs JSC said that if the creditors' interests became paramount when insolvency occurs rather than inevitable liquidation, that would appear to run contrary to the statutory insolvency scheme, and indeed would make the wrongful trading provision (s 214 of the *Insolvency Act 1986* (UK)) largely redundant.[130] Thus, in his Lordship's view creditors' interests would not become paramount at insolvency unless insolvent liquidation or administration was inevitable. Although Lord Hodge DPSC appeared to agree with much of this, his Lordship did say that it was where a company was irretrievably insolvent that the interests of creditors become a paramount consideration in the directors' decision-making.[131] It is not clear whether 'irretrievably insolvent' is the same as insolvent liquidation or administration being inevitable. Lady Arden JSC thought that it was hard to see creditor interests becoming paramount before irreversible insolvency,[132] which seems to suggest something close to or the same as irretrievable insolvency.

Both the Australian jurisprudence and the UK Supreme Court in *Sequana* advocated the position that directors were to consider the shareholders and the creditors' interests, and, certainly, in the case of the Court in *Sequana*, until a company's insolvent liquidation or administration is inevitable when the creditors' interests may become paramount.

D *Need for Director's Knowledge*

Another area of uncertainty that has been the subject of some concern is whether the directors must know of the circumstances that would normally trigger the obligation, before the obligation can be said to have arisen in the particular situation. In other words, is a subjective test to be applied as far as the directors are concerned? On this issue it is possible to identify some difference in the Australian case law. For instance, *Grove v Flavel*[133] suggested that there had to be knowledge on the part of the director in order for the obligation to be triggered. Justice Jacobs said that a director was to have regard to the interest of creditors when the company is known to be insolvent and there is *knowledge* of a real risk of insolvency.[134] Yet, in *Australian Securities and Investments Commission v Somerville*[135] it was indicated that the interests of creditors should be taken into consideration 'where objective circumstances require this'.[136] Little has been said about this issue in the UK authorities, however, in *Sequana* we do find some judicial opinion expressed.

129 Ibid 762 [175]. See also 765–6 [190], 766 [194].

130 Ibid 761 [172].

131 Ibid 779–80 [247].

132 Ibid 792 [290].

133 (1986) 43 SASR 410.

134 Ibid 421.

135 (2009) 77 NSWLR 110.

136 Ibid 123 [37] (Windeyer AJ).

Lord Briggs JSC (with whom Lord Kitchin JSC concurred)[137] and Lord Hodge DPSC[138] considered that the obligation would arise if the directors knew or ought to have known that the company was insolvent or bordering on insolvency or that an insolvent liquidation or administration was probable.[139] Whereas Lord Reed PSC was less certain than Lord Briggs JSC and Lord Hodge DPSC that it was essential that 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, and felt that it was unnecessary and inappropriate to express a concluded view on the issue without hearing argument on the matter.[140] Likewise, Lady Arden JSC said that her Ladyship would leave open the matter to another day.[141] However, her Ladyship did say that directors ought to be aware of the company's financial position and that if they assert that they were not aware of the financial straits of the company the onus should be on them to show that they reasonably ought to be excused, for whatever reason.[142] The approach taken by the majority is consistent with comments made in some earlier cases. In *Re HLC Environmental Projects Ltd (in liq)*[143] John Randall QC (sitting as a deputy Judge of the High Court) rejected the submission that the obligation is only triggered if the director was aware that the company was in the financial state that triggered the obligation.

The majority's test means that it is not dependent totally on subjective considerations, which is the way that legislatures have proceeded with other creditor protection devices. For instance, the tests for both wrongful trading in the UK,[144] and insolvent trading in Australia[145] provide for subjective and objective elements. The wrongful trading test provides that directors are liable if they knew *or ought to have concluded* that there was no reasonable prospect of the company avoiding insolvency liquidation. The test for insolvent trading does not require directors to know that their company was insolvent when debts were incurred before they are liable. They can be liable if there were reasonable grounds for suspecting that the company was insolvent.[146]

137 Ibid 768 [203].

138 Ibid 775 [231].

139 Ibid 768 [203] (Lord Briggs JSC), 775 [231], 777 [238] (Lord Hodge DPSC).

140 Ibid 737 [90].

141 Ibid 789 [281].

142 Ibid 789 [280]. For further discussion of exculpation of directors who are held liable, see Andrew Keay, *Directors' Duties* (LexisNexis, 4th ed, 2020) ch 17.

143 *Re HLC Environmental Projects* (n 23).

144 *Insolvency Act 1986* (UK) s 214.

145 *Corporations Act 2001* (Cth) s 588G.

146 Ibid.

V Reflections and Analysis

The UK Supreme Court, echoing comments made by other judges, some in other jurisdictions, such as Drummond AJA in the Western Australian Court of Appeal in *Bell*,[147] made it clear that the obligation was developing[148] and needed fleshing out,[149] so the Supreme Court judgment in *Sequana* is far from the end of the story, and the justices acknowledged that very fact. Lord Hodge DPSC in *Sequana* said that the scope of liability pursuant to the obligation is to be determined in future in a case in which the matter is relevant to the outcome of the appeal.[150]

The judgment of the UK Supreme Court was never going to provide absolute certainty on all aspects of the obligation. It is arguable that the only things that the Supreme Court said which are binding on lower UK courts is that the obligation clearly exists, it does not arise when there is a real, as opposed to a remote, risk of insolvency of the company and the making of a lawful payment like a dividend could involve a breach of the obligation. It is submitted that much of what the Court said was obiter, as the ratio of the case was quite narrow. Of course, the obiter of a senior court like the Supreme Court will be relied on by counsel in the formulation of their arguments, and it will be shown great respect by judges in lower courts.

Whether or not it is thought that the judgment was worth waiting for is, to a point, likely to depend on the position one holds. For instance, some things will appeal to officeholders and other things to directors.

It is submitted that there are some things that the Supreme Court said that were worth waiting for. First, the fact that the Supreme Court said, without equivocation, that the obligation exists was clearly a positive as far as many are concerned, and this is particularly good news for officeholders who wish to recover funds for creditors. While the respondent in *Sequana* argued strongly that it should not exist, the obligation was surely too well entrenched in the legal systems of several countries including the UK and Australia,[151] to be rejected, unless there were strikingly good reasons to do so, and the Supreme Court said that there were not. Thus, in this regard it was worth waiting for the decision. While a director/respondent might well have some good arguments as to why the obligation does not apply in their case, the respondent is not able to say that the obligation does not exist. Given the corpus of case law that already existed in the UK on the obligation, together with the existence of s 172(3) of the *Companies Act 2006* (UK), it was always going to be difficult for directors to deny the existence of the obligation, but it is comforting for UK officeholders to have the Supreme Court's imprimatur of the obligation's existence and the reasons that are given to justify its existence. The decision will

147 *Bell* (n 42) 364–5 [2039].

148 See also *Sequana* (n 3) 717 [15] (Lord Reed PSC).

149 See also ibid 781 [250] (Lady Arden JSC).

150 Ibid 778 [239].

151 See *Bell* (n 42) 364–5 [2039] (Drummond AJA).

also be comforting to officeholders in other jurisdictions where the obligation has been applied hitherto as it provides another pillar supporting a claim for breach of duty.

Secondly, the decision does provide some further guidance on the trigger for the obligation. It does not provide precision, but some might argue that what the Court has given us is as good as, if not better than, what we previously had from earlier decisions.

Thirdly, the Court has made it plain concerning what directors are to do when the obligation is triggered. That is, until insolvent liquidation or administration is inevitable, when the directors must, generally speaking, treat the interests of the creditors as paramount, shareholders' interests must be considered as well as creditors' interests and thus a balancing exercise needs to be undertaken between creditor and shareholder interests, while there is a consideration of the particular circumstances of the company and its financial position at a given time.[152] Whilst the balancing exercise between shareholders and creditors in such circumstances may not always be easy, this approach does potentially allow businesses to try and work through financially difficult periods for longer than had previously been the case.[153]

Fourthly, some concerns have been expressed from time to time that the obligation might dissuade directors from seeking a restructuring of their distressed company because of fear that they might be liable for a breach of the obligation.[154] Yet, they should take comfort from the fact that Lord Hodge DPSC was of the view that a reasonable decision by directors to attempt to rescue a company's business in the interests of both its shareholders and its creditors would not involve a breach of the common law duty.[155] That is the positive or quasi-positive. What are those matters on which we did not get any certainty, or even guidance? That is, why was the judgment not worth waiting for?

First, the Court did not address directly how the creditor interest duty, as it referred to the obligation, is applied where the interests of individual creditors may not

152 *Sequana* (n 3) 735 [81], 746 [118] (Lord Reed PSC), 762 [177] (Lord Briggs JSC), 829 [430] (Lady Arden JSC).

153 'UK Supreme Court Confirms Creditor Duty in Zone of Insolvency: *BTI v Sequana*', *Katten* (Blog Post, 10 October 2022) <https://katten.com/uk-supreme-court-confirms-creditor-duty-in-zone-of-insolvency-bti-v-sequana> ('UK Supreme Court Confirms Creditor Duty').

154 See, eg, Anil Hargovan and Jason Harris, 'For Whom the Bell Tolls: Directors' Duties to Creditors after *Bell*' (2013) 35(2) *Sydney Law Review* 433.

155 *Sequana* (n 3) 770 [213]. See also Andrew Keay, 'Financially Distressed Companies, Restructuring and Creditors: What is a Director to do?' [2019] *Lloyds Maritime and Commercial Law Quarterly* 297 in which the author argues that directors should not hold grave fears in attempting restructuring if they consider creditors' interests and act reasonably.

be aligned or where the position of certain creditors has worsened in contrast to creditors as a whole. The friction between considering the interests of creditors as a whole and individual creditors is likely to remain.[156]

Secondly, while it is admitted that identifying when the obligation arises is not an exact science, and there is plenty of art (and possibly good fortune) in determining when the obligation applies, identifying the trigger for the obligation is likely to remain challenging and thus can produce uncertainty. There is probably some uncertainty in the legal community as to what is meant by 'bordering insolvency' or 'imminent insolvency' or when does insolvent liquidation or administration become 'probable'? Determining whether a company is insolvent or bordering on insolvency is heavily fact-sensitive and will require the exercise of careful, commercial judgment by directors and the taking of advice. Even then directors might argue that they cannot really be sure that they are doing the right thing.[157] The issue which remains is: when does a 'real' risk of insolvent liquidation (which is not the trigger according to *Sequana*) tip over into a 'probable' one (which is a trigger). How is this going to be assessed in practice? Directors might find it difficult to be comfortable that 'the risk is say 49% … and not 51%', with the former not sparking the obligation but the latter does.[158] It is plainly difficult to know where the line that cannot be crossed without consideration of creditors' interests is placed.

Thirdly, a balancing exercise must be undertaken by directors until the point where insolvent liquidation or administration is inevitable, when the creditors' interests are likely to become paramount, but it is not clear the weight that needs to be placed on the creditors' interests as against those of the shareholders when discharging the balancing exercise. So, just as it remains challenging for directors and their advisers to be sure, in the context of a company's particular circumstances, what is the point where the obligation arises,[159] directors may well not be able to discern when insolvent liquidation is inevitable and, therefore, when the creditors' interests are to be regarded as paramount.

Fourthly, the result of the decision is that directors would not be subject to the obligation if the company is in financial distress, but insolvent liquidation is not probable, thus there does not seem to be anything to prevent directors from entering into a highly risky venture, even if it can be envisaged that if the venture turns sour it would likely lead to insolvent liquidation. Some might feel that that fact gives 'the green light' to directors to embrace extreme risk in an effort to extricate the company from its financial malaise. Directors might be willing to take on such risk as the shareholders will reason that they have likely lost their investment unless

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156 'UK Supreme Court Confirms Creditor Duty' (n 153).

157 Ibid.

158 Kevin Lloyd et al, 'Creditor Duty: The Position after the Supreme Court Decision in BTI v Sequana and Others', *Hogan Lovells* (Blog Post, 5 October 2022) <https://www.engage.hoganlovells.com/knowledgeservices/news/creditor-duty-the-position-after-the-supreme-court-decision-in-bti-v-sequana-and-others>.

159 'UK Supreme Court Confirms Creditor Duty' (n 153).

something is done dramatically to turn around the company's situation. If the high-risk venture does not work then the shareholders are not in a worse position.

How might the various stakeholders regard the judgment? The decision might provide more detail for lawyers in order to advise clients, but it might not provide much succour for officeholders and directors. Officeholders, who have to make the final decision about whether or not to instigate proceedings, and funders who will provide the necessary financial support in many cases, might understandably feel that the Supreme Court has made their job of holding directors accountable more difficult. While the formulae that has been used in the past were never precise, many of them were suggestive of the fact that the company did not have to be as close to insolvency as the *Sequana* decision seems to indicate. The Court's triggers for the obligation are, generally, further down the track towards insolvency than many that have been propounded both in the UK and Australia. Clearly the Court did not approve as a trigger the fact that a company was in financial distress or was experiencing a risk of insolvency. That might well give officeholders less leeway in making their final decisions as the window in which the obligation arises appears to have got smaller. Thus, this might lead to the instigation of fewer claims against directors. All of this might, on the contrary, be seen as something positive as far as directors are concerned as it does not restrict them, potentially, as much when a company is financially distressed but not bordering on insolvency. Nevertheless, as mentioned above, directors might have some difficulty knowing when their company has passed into the zone of bordering on insolvency.

Directors may feel more pleased than officeholders. However, in the light of *Sequana*, judgment calls will remain difficult where they are required to assess where on the sliding scale of insolvency the company is actually situated in order to permit them to ascertain where the balance of competing interests between the company's various stakeholders should lie.[160] In her Ladyship's judgment, Lady Arden JSC said:

> The progress towards insolvency may not be linear and may occur not as a result of incremental developments but as a result of something outside the company which has a sudden and major impact on it. The task for directors is not simply to weigh the interests of shareholders against those of creditors. It is to manage all the interests in the company unless and until the point is reached whereby, they must treat creditors' interests as predominant.[161]

160 'BTI v Sequana: Key Supreme Court Insolvency Ruling Clarifies Stance on Creditor Duties', *Herbert Smith Freehills* (Blog Post, 18 Oct 2022) <https://www.herbertsmithfreehills.com/latest-thinking/bti-v-sequana-%E2%80%93-key-supreme-court-insolvency-ruling-clarifies-stance-on-creditor> ('Key Supreme Court Insolvency Ruling').

161 *Sequana* (n 3) 794 [303].

One law firm has noted:

> despite best-laid plans, directors may still face significant challenges when it comes to identifying and responding promptly and effectively to circumstances which may threaten the existence of the company so as to minimise the risk of personal liability.[162]

The law firm which acted for the appellant in *Sequana* has stated that it seems odd that the Court found the payment of the dividend to be in breach of s 423 of the *Insolvency Act 1986* (UK), which involves finding that the purpose of the transaction, the paying of a dividend, was to put assets beyond the reach of creditors, but at the same time the authorisation of the dividend payment was found not to be in breach of the obligation. The reason that the firm finds it odd is that it seems clear that such a transaction is not in the interests of the company's creditors,[163] although, of course, the Court said that the main point was that at the time of the making of the dividend the obligation had not been triggered. In many respects the process that directors employ should not be changed by the decision and they must be well-informed in carrying out their decision-making. In *Sequana*, Lady Arden JSC said:

> Directors should always have access to reasonably reliable information about the company's financial position. The message which this judgment sends out is that directors should stay informed. The company must maintain up to date accounting information itself though it may instruct others to do so on its behalf. Directors can and should require the communication to them of warnings if the cash reserves or asset base of the company have been eroded so that creditors may or will not get paid when due. It will not help to resign if they remain shadow directors. In addition, directors can these days without much difficulty undertake appropriate training about their responsibilities, and about the penalties if they disregard them.[164]

How does the decision impact Australia? Obviously the *Sequana* decision is not binding on Australian courts, but it is likely to be persuasive, and the comments of the justices in *Sequana* will be relied on by some counsel to support their arguments. As in the UK, the acceptance of the existence of the obligation will be heartening for liquidators, not that there is any suggestion in the judicial opinion in Australia that the obligation does not exist. Also, there were several comments made by the justices that will be of assistance to liquidators and directors alike concerning the nature of the obligation. Where there might be a more limited embracing of the decision is in relation to the trigger for the obligation. There has been an acceptance in several Australian superior courts[165] that the obligation arises when there is a real and not remote risk of insolvency. Clearly, *Sequana* rejected that as a trigger and so what the justices said about the trigger may well be of restricted use. However, with the content of the obligation there is greater agreement between *Sequana* and what

162 'Key Supreme Court Insolvency Ruling' (n 160).

163 Lloyd et al (n 158).

164 *Sequana* (n 3) 794–5 [304].

165 See, eg: *Kalls Enterprises* (n 18) 589 [162] (Giles JA); *Termite Resources NL (in liq) v Meadows [No 2]* (2019) 370 ALR 191.

has been said generally in Australia. This is particularly in relation to the fact that the obligation means that the directors must consider the interests of shareholders and creditors except where the company's financial position is very bad.

VI Conclusion

While a UK Supreme Court judgment is always usually worth waiting for and this applies to an extent where the *Sequana* decision is concerned, clearly the decision is not the panacea that all would like in order to resolve the issues that have been related to the obligation ever since its early days. There remains uncertainty concerning the point where the obligation is triggered and it is not totally clear what directors have to do when the obligation has been triggered and how they are to treat the interests of the shareholders and the creditors.

Everyone probably had unreasonable expectations of the judgment. All issues could not be resolved completely, and this is the case given the fact that much of what the judges said was obiter. Nevertheless, it can be said that it constitutes a milestone in the development of the obligation, and it does provide some guidance and some assistance.

The Supreme Court judgment will be construed by a wide range of affected people as well as those not directly or indirectly affected. It will be considered by directors, shareholders, financiers, auditors, litigation funders, investors, and officeholders, as well as lawyers and academics, and all may see different positives and negatives in the judgment. As far as the future is concerned, it will be interesting to see three things. First, will the decision lead to changes in the conduct of directors? Secondly, will it result in fewer proceedings being commenced by officeholders, particularly in the UK? Thirdly, how will lower courts in both the UK, and other common law jurisdictions like Australia where the obligation has been relied on successfully, treat the comments of the justices in *Sequana* which do not form the ratio of the case.