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In search of a remedy: creditor duty post *Sequana* and the quest for certainty

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Abstract

This article analyses the UKSC decision in *BTI 2014 v Sequana* and its relevance on the creditor duty obligation on corporate insolvency. The article explores the newly affirmed creditor duty on company directors and the absence of a defined remedy for directors' breach. It also explores some of the approaches from Canada and Ireland on the topic of creditor duty obligation and how these may inform the UK's approach. The article concludes by recommending a codified creditor duty with a corresponding remedy in the form of extending the derivative action to creditors as it is the case with shareholders.

1. Introduction

For decades, the notion of creditor duty on corporate insolvency has remained a grey area in English company law. While this topic has appeared on the agendas of legislative, academic and judicial recommendations for reform, uncertainty still looms over this area of company law.¹ This may be born out of the contention that while other directors' statutory duties are aimed at dealing with internal affairs of the company and its relationship with shareholders,² the creditor duty is engaged during times of financial difficulties and specifically, for creditors who are owed money and other interests to which corporate insolvency greatly impact.³

Even though English company law recognises the fiduciary obligations owed by company directors to creditors to consider their interests when the company they are invested with is

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¹ A. Keay, "The duty of directors to take account of creditor interests: has it any role to play?" [2002] JBL 379, 386; A. Keay, "Directors' duties and creditors' interests" (2014) 130 LQR 443 – 458; John M. Wood, "Directors' duties post insolvency" 2021, 32(7), ICCLR 371-386; J. Quinn and P. Gavin, "The creditor duty post Sequana: lessons for legislative reform" (2023) 23(1) JCLS 271 - 296. See also, Company Law Review Steering Group, *Modern Company Law for a Competitive Economy- Developing the Framework* (March 2000) paras 3.72-3.73; Company Law Review Steering Group, *Modern Company Law: Final Report* (July 2001).

² Companies Act 2006, s.171 – 177.

³ This duty is mandated under the Companies Act, 2006, s.172(3).

insolvent or in financial difficulties,⁴ the scope of this duty and the extent and/or degree of financial difficulties to warrant this creditor duty remains undefined and continues to cause both academic and judicial debates.⁵ The UK Supreme Court (UKSC), in 2022 gave the long-awaited judgment in *BTI 2014 LLC v Sequana*,⁶ with great expectation that this grey area of company law would at last, become clearer, as to the trigger point and at least, a list of judicially defined instances that would call for the creditor duty.

However, the UKSC did not conclusively provide the much-anticipated clarity to this grey area. Neither a defined trigger point, nor a defined list of instances to trigger the creditor duty was given. Instead, the UKSC chose to adopt a contextual approach, where the creditor duty's trigger point and the degree of risk to affected creditors is based on the specific case, meaning – a case-by-case approach.⁷ However, the UKSC confirmed the existence of the creditor duty obligation on company directors where the company's insolvency was imminent or unavoidable.⁸ Nevertheless, it did not provide a remedy to creditors for directors' breach of the creditor duty like it is the case for shareholders, where a wrong has been committed to a company itself or shareholder rights have been handled in unfair and prejudicial conduct.⁹

This article analyses the UKSC decision in *BTI 2014 v Sequana*, its relevance on the creditor duty obligation on corporate insolvency and what the absence of a clearer guiding criteria and/or framework by the UKSC to this area of company law means for both company directors and creditors when the company to whom they are invested goes into insolvency. The article explores the affirmed creditor duty on company directors and the absence of a defined remedy for directors' breach. It then explores some of the approaches from other

⁴ Mainly under the Companies Act 2006, s.172(3) which states that "The duty imposed by this section has effect 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."

⁵ A. Hargovan and J. Harris, "For Whom the Bell Tolls: Directors' Duties to Creditors After Bell" (2013) 35 Syd LR 433; Keay (n 1); Wood (n 1); and Quinn & Gavin (n 1). See further, cases such as *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] B.C.C. 885; *Re Idessa (UK) Ltd* [2011] EWHC 804 (Ch); [2012] B.C.C. 315; *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch).

⁶ *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25. (Hereafter, *Sequana* (UKSC)).

⁷ J. Quinn and P. Gavin, "The creditor duty post Sequana: lessons for legislative reform" (2023) 23(1) JCLS 271 - 296.

⁸ *Sequana* (UKSC) paras 46 – 51; 250, 261.

⁹ J. Hardman, "An institutional analysis of UK ostensible minority shareholder protection mechanisms" (2023) 23(2) JCLS, 397-436; Hamiisi J. Nsubuga, "Fifteen years of the statutory derivative regime under the Companies Act 2006 - a reflection on an unfulfilled superfluous statutory regime" (2023) 15 CIL 63, 81.

jurisdictions, such as Canada and Ireland on the topic of creditor duty obligation and how these approaches may provide some guidance to the UK. The article concludes by recommending a codified creditor duty with a corresponding remedy in the form of extending the derivative action to creditors as it is the case with shareholders.

2. The creditor duty – a historical overview

For decades, following the decision of the Australian High Court in *Walker v Wimborne*,¹⁰ there has been a developing jurisprudence on company directors' obligation to consider the creditors' interests (creditor duty) when the company under their control is in financial distress across several common law jurisdictions. These include for example, New Zealand,¹¹ Hong Kong,¹² Australia,¹³ Ireland,¹⁴ England and Wales,¹⁵ among other countries. However, despite these common law judgments and accompanying jurisprudence, there has yet to be clear criteria on what the exactly, the creditor duty on directors entail, when it is engaged, the factors to be explored and the remedies (if any) to creditors for directors' breach of such duty.

The UK as one of the leading jurisdictions in the common law world, and one of the leading trend-setters of common law jurisprudence has explored this duty since 1988 in what came to be known as the *rule* in *West Mercia* (following the case of *Liquidator of West Mercia Safetywear Ltd v Dodd*,¹⁶ (explored below) and recently in *BTI 2014 LLC v Sequana*.¹⁷ Although the notion of creditor duty and when it is engaged was to a larger extent explained by the judges,¹⁸ the other notion of whether such duty should be codified and accompanied by remedies for directors' breach of such a duty were not broadly discussed.

¹⁰ *Walker v Wimborne* (1976) 137 CLR 1.

¹¹ *Nicholson v Permakraft* [1985] 1 NZLR 242.

¹² *Moulin Global Eyecare Holdings Ltd v Lee Sin Mei* [2014] HKCFA 63.

¹³ *Walker v Wimborne* (1976) 137 CLR 1; *Kinsela v Russell Kinsela Pty Ltd*; (1986) 4 NSWLR 722; *The Bell Group Ltd (ACN008 666 993) v Westpac Banking Corporation* [2008] WASC 239; *Westpac Banking Corporation v The Bell Group Ltd (in liq)* [2012] WASCA 157.

¹⁴ *Re Frederick Inns Ltd* [1994] 1 ILRM 387; *Re Swanpool Ltd* [2006] 2 ILRM 217.

¹⁵ *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30 (Hereafter, *West Mercia*); *BTI 2014 LLC v Sequana* [2022] UKSC 25; *Hunt v Singh* [2023] EWHC 1784 (Ch).

¹⁶ (1988) 4 BCC 30.

¹⁷ [2022] UKSC 25.

¹⁸ *Sequana* (UKSC), Lord Briggs, at [203]; Lord Hodge, at [231]; [238]; Lord Reed, at [90] and Lady Arden at [281].

Following the case of *West Mercia* in 1988, and later buttressed by statute,¹⁹ a rule was developed in English company law that when a company is either within the vicinity of insolvency, or inside insolvency proceedings, the focus of directors' duty should shift from members and/or shareholders to creditors to ensure that due regard is accorded to creditors' interests.²⁰ In this case, the Court of Appeal held that the decision by Mr Dodd, a director of an insolvent company to authorise a payment of a debt owed by the company to its insolvent parent company it had guaranteed, was a breach of his duty as a director.

Mr Dodd had authorised a payment of £4000 as a way of reducing his own liability. The court stated that this act by Mr Dodd was in disregard of creditors' interests in the insolvent company, and therefore, a breach of duty. The court ordered Mr Dodd to repay the amount back to the company. This rule became to be known as the rule in *West Mercia* and followed by the Court of Appeal in *BTI 2014 LLC v Sequana SA*,²¹ where it concluded that it was bound by it that directors owed a duty of loyalty to creditors upon insolvency.²² The rule was further followed on appeal by BTI 2014 LLC to the UK Supreme Court (discussed below).

In *Re systems Building services Group Ltd*,²³ the Insolvency and Companies Court of England further explored the creditor duty and attempted to answer the question whether directors' duties apply post-insolvency and the extent to which this duty applies. After suffering financial difficulties, System Building Services Group Ltd entered into administration on 12 July 2012. Unable to rescue the business as a going concern while in administration,²⁴ the company exited administration and opted for a company voluntary liquidation on 3 July 2013 and was subsequently dissolved on 24 February 2016. However, Mr Michie, the sole director and shareholder of System Building Services Group Ltd, with the knowledge of the company's financial situation, purchased from it, a property at £120,000 in 2014 which was approved by

¹⁹ Companies Act 2006, s.172(3).

²⁰ *Bilta (UK) Ltd (in liquidation) and ors v Nazir and ors (No 2)* [2016] AC 1, para 123, per their Lordships - Toulson and Hodge.

²¹ *BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112.

²² *ibid*, at [143].

²³ *System Building Services Group Ltd*, [2020] B.C.C. 345.

²⁴ The objectives sought by a company filing for administration proceedings are codified in the Insolvency Act 1986, Sch. B1, Para 3(1)(a) –(c), with the main objective of rescuing the company as a going concern.

the liquidator (Mrs Sharma) who was later dismissed, and another liquidator (Mr Hunt) appointed.

While investigating the company's affairs, the new liquidator (Mr Hunt) discovered that the property that Mr Michie had purchased from the financially stricken company was purchased at undervalue. He also discovered that there had been several payments out of the company's bank account to a third party shortly after the company had entered into administration. The liquidator brought a misfeasance claim²⁵ against Mr Michie that he had breached his fiduciary duties by purchasing from the company, a property at undervalue for selfish interests and without regard to the interests of the creditors as a whole.

Judge Barber of the Insolvency and Companies Court held that directors' duties, whether a company was inside or outside insolvency continued to apply notwithstanding the commencement of certain proceedings, such as administration or creditors' voluntary liquidation as was the case in this case. The duties remain independent of and run parallel to the duties owed by the administrator or liquidator appointed by the company.²⁶ Transcending into insolvency by the company does not alter already existing directors' duties, other than refocusing such existing duties and the obligations hitherto. In this sense, insolvency places more due diligence on directors to consider decisions made, ensuring that stakeholder interests including those of creditors are considered. Therefore, the director (Mr Michie) had acted entirely out of self-interest and failed to have regard to the interests of the creditors, in purchasing the property at undervalue among other transactions.²⁷

However, most interestingly, the court held that in assessing whether creditors' interests as whole were adequately considered by directors in executing certain transactions and decisions, an objective test is applied.²⁸ This test tasks the court to assess whether an intelligent and honest person occupying the position of a director would, in the circumstances, reasonably believed that the transaction was to benefit the creditors as a whole.²⁹ This was

²⁵ See, Insolvency Act 1986, s.212.

²⁶ *System Building Services Group Ltd*, [2020] B.C.C. 345, at [39].

²⁷ *ibid*, at [117].

²⁸ *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch. 62, Per Pennycuik J, para 74. On this point, see further, the opinions of the judges in *Hellard v Carvalho* [2014] B.C.C. 337 paras 91 – 93; *Wow Internet Ltd* [2020] EWHC 2890 (Ch) at [34].

²⁹ *System Building Services Group Ltd*, [2020] B.C.C. 345, at [117].

held not to be case as Judge Barber concluded that Mr Michie had breached his duties to the company and creditors as a whole, occasioning section 172(3) of the Companies Act 2006.³⁰ In 2022, the UKSC had another opportunity to address the creditor duty obligation on company directors and related jurisprudential aspects. This is explored below.

2.1 BTI 2014 LLC v Sequana [2022] UKSC 25 - the facts

In May 2009, the directors of AWA, a wholly owned subsidiary of Sequana declared a dividend of 135 million Euros to fully extinguish a substantial debt owed by Sequana to AWA. The dividend was declared while AWA was in good financial health (both balance sheet and cashflow). However, AWA did have significant long-term pollution related contingent debts of an uncertain amount and assets of uncertain value. There was, therefore, a real risk that AWA might become insolvent in the future despite insolvency not being imminent or probable at the time.

However, in October 2018 AWA entered insolvent administration and BTI 2014 LLC – the assignee of AWA sought to recover the amount of the dividend. BTI 2014 LLC claimed that the dividend was declared in breach of directors’ duties, it was prejudicial to AWA’s creditors and that directors had not considered nor acted in the interests of AWA’s creditors. Both the High Court and the Court of Appeal held against BTI 2014 LLC’s claims, but it appealed to the Supreme Court. The Supreme Court delivered its judgement on 5 October 2022, on the circumstances and extent to which if at all, the interests of the company, for the purpose of the directors’ duty to act in good faith in its interests, are to be understood as including the interests of its creditors as a whole.³¹

2.2 Creditor duty confirmation and the ensuing legal uncertainty

The sitting judges acknowledged that it was clear that the creditor duty/ rule in *West Mercia*,³² had a legal basis,³³ as it was recognised in English company law before the enactment of the

³⁰ *ibid*, at [120].

³¹ Lord Briggs delivering the principal judgment.

³² Please note that the judges used two different phrases in giving their opinions while referring to the duty on directors to take account of creditors’ interests arising under CA 2006, s.172(3). While Lord Briggs, Lord Kitchin and Lord Hodge used the term “creditor duty”, Lord Reed and Lady Arden used “the rule in *West Mercia*.”

³³ *Sequana* (UKSC), at [46] – [51]; [250], [261].

CA 2006, and hence, preserved by section 172(3) of the CA 2006.³⁴ However, the court rejected the contention raised in the Court of Appeal and in some of the authorities, that there is a creditor duty distinct from the directors' fiduciary duty to act in the interests of the company upon corporate insolvency.

For instance, Lord Reed reiterated that it was important to understand that the rule in *West Mercia* does not create a new duty, but it merely adjusts the long-established fiduciary duty to act in good faith in the interests of the company.³⁵ Although he acknowledged that there were circumstances in which the interests of the company, for the purposes of the latter duty, may be understood as including the interests of its creditors as a whole,³⁶ he observed that there was a risk of confusion if this was described as a creditor duty as the parties had described it by loose or perhaps metaphorical use of legal terminologies.³⁷ These includes for example, describing creditors as 'beneficially interested in the company or contingently so'³⁸ or by speaking of the company's assets becoming the creditors' assets 'in a practical sense',³⁹ or 'it is the creditors' money which is at risk.'⁴⁰

He emphasised that there is not a duty owed to creditors, or any duty separate from the directors' fiduciary duty to the company.⁴¹ Instead, it is a rule that modifies the ordinary rule whereby, for the purposes of the director's fiduciary duty to act in good faith in the interests of the company, the company's interests are taken to be equivalent to the interests of its members as a whole. Lady Arden was also of the opinion that the rule in *West Mercia* is concerned with protecting creditors from harm and it does not require directors to run the business for the benefit of creditors.⁴² Therefore, the rule in *West Mercia* does not create a duty owed to the creditors, and the duty to promote success remains a duty which is owed to

³⁴ *Sequana* (UKSC), at [76].

³⁵ *Sequana* (UKSC), at [77].

³⁶ *Sequana* (UKSC), at [11].

³⁷ *Sequana* (UKSC), at [44].

³⁸ *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242, at [249].

³⁹ *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215, at [730].

⁴⁰ *ibid*, at [733].

⁴¹ *Sequana* (UKSC), at [11] – [12].

⁴² *Sequana* (UKSC), at [264]; [288].

the company.⁴³ The Their Lordship, Briggs,⁴⁴ and Hodge,⁴⁵ also agreed with Lady Arden's and Lord Reed's observations.

2.3 Creditor duty test and trigger point conundrum

The judgement in *Sequana* has at least, provided some clarity as to the extent company director ought to consider and/or take account of creditor interests when the company under their control is either insolvent, or imminently insolvent.⁴⁶ However, the test on when exactly the director duty shift on corporate insolvency should be triggered was not clearly outlined, yet this has proved problematic over time within English courts. For example, in *Bilta (UK) Ltd (In Liquidation) v Nazir*,⁴⁷ the court held obiter that the duty shift applied at the point that the company was bordering on insolvency.⁴⁸

In *Sequana*, the judges did their best to distinguish between situations where a company is deemed to be insolvent or bordering (within the vicinity of) insolvency, and situations where, the company's insolvency is imminent, therefore, insolvent liquidation or administration is inevitable based on the provisions of section 172(3) of the Companies Act 2006.⁴⁹ The judges acknowledged that the company must be insolvent at the time, or where insolvency was reasonably imminent for the creditors' duty to arise. However, they gave differing instances and/or scenarios of what exactly would aid directors' judgement or assessment of the company's financial situation such that an efficient business decision may be made. The rationale for such differing scenarios may be born out of the fact that a majority of companies may find themselves bordering on insolvency or within the vicinity of insolvency, yet such situations may be temporary, and the company may revert back to good financial health.⁵⁰

Lord Briggs cited an example of a small start-up business that is balance sheet insolvent by a small margin but effectively honouring its trade invoices as they fall due. His Lordship

⁴³ *Sequana* (UKSC), at [261].

⁴⁴ *Sequana* (UKSC), at [205].

⁴⁵ *Sequana* (UKSC), at [206]; [224].

⁴⁶ P. de Carvalho and B. Reddy, "Credit Where Credit's Due: The Supreme Court Take on Directors' Duties and Creditors' Interests" (2023) 82(1) CLJ 17, 20.

⁴⁷ *Bilta (UK) Ltd (In Liquidation) v Nazir* [2015] UKSC 23; [2016] A.C. 1.

⁴⁸ *ibid*, at [123].

⁴⁹ *Sequana* (UKSC) at [46] – [51]; [250], [261].

⁵⁰ Peter Walton, "Triggers, Content, and Enforcement: Directors' Duties to Creditors – Where are We After *Sequana*?" (2024) 9 WLJ 5 – 21.

questions why directors of such a company would abandon the pursuit of the company's success.⁵¹ Lady Arden likened the task expected of directors in invoking the creditors' duty shift to a sliding scale.⁵² She acknowledged that a sliding scale analogy provides some assistance, but cautioned that the sliding scale analogy should not be taken too literally as the task for directors is not simply to weigh the interests of shareholders against those of creditors but to manage all the interests in the company unless and until the point when the company is irreversibly insolvent then they must treat creditors' interests as predominant.⁵³ Hence, the greater the likelihood of and/or imminence of insolvency, the more the scale is tipped towards prioritising creditor interests such that creditors' interests as a whole are not prejudiced by directors.⁵⁴

Therefore, where a company is insolvent or bordering insolvency, the task and/or duty for the directors is to consider creditors' interests (along with those of the members/shareholders) as a 'must' but once the company is in insolvent liquidation or administration, the duty for the directors is to 'act in the interests of creditors' as creditors' interests become paramount.⁵⁵ The rationale is to avoid or limit potential and/or further losses for creditors, and to ensure that creditor priorities in potential or subsequent formal insolvent distributions are not disrupted/violated.⁵⁶ The test on assessing whether or not directors have executed the creditor duty diligently is a subjective one. The decisions or actions taken by directors at this point must be in good faith, in the interest of creditors. Otherwise, an objective test may be applied by the court in assessing whether the conduct of the directors in question would be consistent with those of an intelligent and honest person, and for the benefit of creditors.⁵⁷

It is therefore the case that the judges in *Sequana* further confirmed the existence of the creditor duty on directors where the company under their control is either insolvent or imminently insolvent, and failure to engage the duty, the director would be in breach of the duty. However, the judges did not provide and/or prescribe a remedy to creditors for the

⁵¹ *Sequana* (UKSC), at [173], per Lord Briggs.

⁵² *Sequana* (UKSC), at [303].

⁵³ *Sequana* (UKSC), at [303]; [306].

⁵⁴ *Sequana* (UKSC), per Lord Reed, at [45], [48] – [50] and Lord Briggs at [112], [135], [139]–[142].

⁵⁵ *Sequana* (UKSC), per Lord Reed at 11 and Lord Briggs paras 165; 176.

⁵⁶ *Sequana* (UKSC), Lady Arden at [288].

⁵⁷ On the objective test, see cases, such as *Re Smith and Fawcett Ltd* [1942] Ch. 304; *Charterbridge Corp v Lloyds Bank Ltd* [1970] Ch. 62; *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748.

directors' breach of and/or failure to engage the creditor duty. This has left the creditors in search of remedy.

3. In search of a remedy

As the company enters insolvent liquidation proceedings,⁵⁸ creditors assume the main economic stake in the company as opposed to shareholders/members as being entitled to the company's residual wealth.⁵⁹ Although creditors as a special class are not mentioned in the CA 2006, section 172(1), they are given some form of legislative recognition in the list of matters to which the directors are to have regard under section 172(3) as the list is not exclusive. Moreover, certain creditors, such as employees and trade suppliers are likely to form important classes of a company's creditors as it approaches insolvency.⁶⁰

However, on signs of financial difficulties, or where the company's insolvency is imminent, directors may engage in ambitious and excessive risk-taking with hope that they may overcome the financial difficulties. This may not only prejudice the company as a whole, but creditors as well.⁶¹ Yet, the directors may not have to answer for such costly risk-taking unless found guilty under insolvency legislation for wrongful trading,⁶² which is a form of insolvency officer-holder action.⁶³ Directors may also make business decisions that are clearly detrimental to creditors to the extent that no reasonable director could have taken such decisions while having regard to creditors, such as dissipation of assets where it is clear the company will end up in insolvent liquidation. Nevertheless, creditors may find it difficult to

⁵⁸ Liquidations may involve voluntary and compulsory liquidations both governed by the Insolvency Act 1986. See particularly, Insolvency Act 1986, s.84, for members' voluntary liquidation, and s.122, for compulsory liquidation under the guidance of the court upon filing by a creditor.

⁵⁹ Per the reasoning in *Brady v Brady* (1988) 3 BCC 535 at 552; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 ACLC 215. See further; A. Keay, "Directors' Duties and Creditors' Interests" (2014) 130 LQR 443; A. Keay, "Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interests" (2020) 136 LQR, 52, 65–66.

⁶⁰ Further reemphasised by Lord Briggs (with whom Lord Kitchin agreed) in *Sequana (UKSC)*, at [141].

⁶¹ Rosemary Langford and Ian Ramsay, "The contours and content of the 'creditors interests duty'" (2021) 21(1) JCLS 85.

⁶² Insolvency Act 1986, s.214. This section 214 applies only where the directors knows or ought to know that there was no reasonable prospect of avoiding insolvent liquidation or administration but continued to trade, leading to more losses to the company. See further, Hamisi Junior Nsubuga, "A reconsideration of directors' duties for wrongful trading in the UK and EU in the COVID19 era" In Vaccari, E. (eds), *A Collection of Short Papers by INSOL Early Research Academics*, (London: INSOL International, 2022) 128 – 138.

⁶³ A. Keay, "The Shifting of Directors' Duties in the Vicinity of Insolvency" (2015) 24 IIR 140; K. van Zwieten, "Director Liability in Insolvency and Its Vicinity" (2018) 38(2) OJLS 382, 389; Langford & Ramsay (n 61).

pursue remedies against the directors for fear of factors, such as cost implications and only hope that the appointed liquidator brings proceedings to hold such directors accountable.

Moreover, as directors control the daily management of the company, either as a solvent or insolvent going concern, they may not resolve to bring legal proceedings against fellow directors for breach of duties (in the name of the company) like shareholders would. Yet this provision is not currently available to creditors despite their interest being afforded judicial right of consideration by the judges in *Sequana*. In addition, directors may choose to exercise their power to ratify purported director's breach, or work with shareholders/members to ratify such conduct where it would benefit members/shareholders against creditor interests.⁶⁴

In terms of creditors' right of enforcement for breach of the creditor duty by directors, the judges in *Sequana* discussed two situations where liability for directors' breach may arise. The first is where directors failed to consider creditors' interests where the company's insolvent liquidation is inevitable, consequently leading to further loss to the company's distributable assets to creditors during winding up.⁶⁵ The second is where directors made a preference payment to one or more creditors in priority to other creditors. The directors' breach in the first situation may potentially be actionable under section 214 Insolvency Act 1986 – in a form of a wrongful trading action, and the second situation potentially actionable under section 239 of the Insolvency Act 1986 – via a voidable transaction action.

In addition, directors may also be subject to a disqualification order primarily under section 6 of the Company Directors Disqualification Act 1986 (CDDA) for their breach or omissions. In such circumstances, the court may grant a compensation order on the director to contribute to the company's losses in the form of compensation to creditors generally or individually.⁶⁶ However, all these actions are officeholder actions, exercised by the officeholder, such as the liquidator during his/her term of appointment and not the affected creditors. The concern is that the appointed officeholder may place different weight on different factors that may not

⁶⁴ *Re Duomatic Ltd* [1969] 2 Ch 365.

⁶⁵ Such as in *Re Brothers Produce Ltd* [2022] EWHC 291 (Ch) where a disposition of company assets after the date of the petition by the directors at an undervalue was held to be a void disposition under s.127 of the Insolvency Act 1986.

⁶⁶ Company Directors Disqualification Act (CDDA), 1986, s.15.

entirely be in the interests of creditors, or where a potential creditor is impacted more than others.

3.1 The call for a creditor duty derivative action

Codified in the CA 2006, Part 11, Sections 260 – 269, a derivative action is one of the remedies available to members/shareholders,⁶⁷ where a wrong has been committed to a company but the directors have not taken the initiative to seek a remedy. Through a derivative action, a member/shareholder may initiate or continue a claim against any company director,⁶⁸ in relation to negligence, default, breach of duty or breach of trust.⁶⁹ The claimant need not be a member/shareholder at the time the alleged breach or misconduct happened.⁷⁰ The process is court-controlled as permission must be sought and approved by the court via two stages.⁷¹ Stage one is for the member to prove a prima facie case,⁷² while stage two involves the court's consideration of the evidence presented with a high degree of judicial discretion exercised in interpretation of the list of factors under section 263(3) in order to decide whether to grant or reject the member's application.

Where successful, the company is compensated for the wrong or loss made to it.⁷³ This is because, a statutory derivative action would not only enable the member/shareholder to seek a remedy in the name and on behalf of the company, but would also, ensure that the company receives an appropriate remedy in lieu of the wrong suffered, usually compensation and the recovered interest and/or compensation is recycled back into the pool of distributions to creditors. In *West Mercia*, the court ruled that a director's breach of fiduciary duty may give rise to an action for a remedy pursued by the company itself, its assignee, or a shareholder via a derivative action but this was not extended to a creditor per se.

⁶⁷ This section focuses primarily on the derivative action as a shareholder remedy due to the scope of the paper. Other shareholder remedies outside insolvency, such as the unfair prejudicial conduct remedy under CA 2006, s.994-996; fraudulent trading under Companies Act 2006, s.993 and fair and equitable winding up under Insolvency Act 1986, s.122 are not discussed where mentioned as these are not mainly collective in approach.

⁶⁸ This may include present and former directors including shadow directors. See, Companies Act 2006, Pt 11, s.260(5).

⁶⁹ Companies Act 2006, s.260(3).

⁷⁰ Companies Act 2006, s.260(4).

⁷¹ Companies Act 2006, s.261.

⁷² Companies Act 2006, s.262.

⁷³ A. Keay, "Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006" (2016) 16(1) JCLS 39-68.

Therefore, it would be a welcome achievement to extend the derivative regime to creditors to allow them to initiate and/or continue a derivative action on behalf and in the name of the company during corporate insolvency. It would make creditors permitted to take direct action against company directors for breach of creditor duty and the company at large. This would echo Lady Arden's view (with whom Lords Reid and Hodge agreed) in *Sequana* that the reason for the creditor duty obligation was that the obligation redressed the situation in which creditors, who had a greater economic interest in the company than shareholders on insolvency had no control over the conduct of its business.⁷⁴

3.2 Why a codified creditor duty and remedy

Codification of the creditor duty and extending the already codified derivative action (Companies Act 2006, Part 11, ss 260 – 269) to creditors would introduce a degree of clarity beyond the current common law position, particularly in relation to the trigger point (and factors) of the creditor duty, and remedy (derivative action) to creditors upon breach of the creditor duty. For example, it may be the case that the reading, scope and operation of section 172 of the Companies Act 2006 is amended to separate the directors' duty to promote the success of the company and include a subsection on an obligation/duty to consider creditor interests on insolvency accompanied by trigger factors. The same goes for the need to amend sections 260 – 269 on derivative action to shareholders to extend it to creditors on corporate insolvency.

While rejecting the test for 'real risk of insolvency' in *Sequana*,⁷⁵ the UKSC acknowledged that future liabilities were not to be ignored by directors, and that they should consider liabilities in the near future but the length at which they should look into the future was a matter for the legislature.⁷⁶ As the UKSC also acknowledged that this complex issue was a matter for the legislature, this era (Post *Sequana*) provides an opportune moment for both the Company Law Review Steering Group (CLRSG) and the Law Commission of England and Wales to reconsider this area of company law having previously, approached the matter with caution in their

⁷⁴ *Sequana* (UKSC), at [263].

⁷⁵ *Sequana* (UKSC), at [84]; [79].

⁷⁶ *ibid.*

reports and recommendations that led to the enactment of the Companies Act 2006, and the codification of directors' duties and shareholder remedies.

For example, the CLRSG in their report in March 2000,⁷⁷ had explored whether there should be a statutory statement of a duty of directors to consider foremost the interests of creditors when a company is insolvent or threatened with insolvency but opted for this issue to be based/decided by insolvency legislation, mainly, the Insolvency Act 1986, such as under section 212,⁷⁸ section 214,⁷⁹ and section 239⁸⁰ among other sections.⁸¹ However, in its subsequent report in November 2000,⁸² the CLRSG acknowledged that directors' duties must be subject to the overriding duty towards creditors in an insolvency situation but was not in favour of laying down any detailed new rule and/or duty, opting for this issue to be explored by the draftsman.⁸³

In its final report published on 26 July 2001,⁸⁴ the CLRSG acknowledged that arguments had been advanced on consultation in favour of a statement of a duty towards creditors in insolvency, as insolvency may occur unexpectedly and that limited liability exposed creditors to the risk of loss.⁸⁵ The report therefore, proposed that the statutory statement should contain principles requiring directors to 'have regard to the interests of creditors in relation to threatened insolvency.'⁸⁶ Unfortunately, the members of the CLRSG failed to reach an agreement on the inclusion in the statutory statement of an obligation to consider the interests of creditors.

⁷⁷ Company Law Review Steering Group, *Modern Company Law for a Competitive Economy- Developing the Framework* (March 2000).

⁷⁸ This section deals with misfeasance claims brought by a liquidator against a director during insolvent liquidation. For instance, see *System Building Services Group Ltd*, [2020] B.C.C. 345.

⁷⁹ Under a wrongful trading action. See further, Nsubuga (n 62).

⁸⁰ This section applies where the company directors have caused the company to pay one (or more) creditor in priority to other creditors. This section affords the liquidator power to attack a voidable preference.

⁸¹ Company Law Review Steering Group, *Modern Company Law for a Competitive Economy- Developing the Framework* (March 2000) at paras 3.72-3.73.

⁸² Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure* (November 2000).

⁸³ *ibid*, para 3.12.

⁸⁴ Company Law Review Steering Group, *Modern Company Law: Final Report* (July 2001).

⁸⁵ *ibid*, paras 3.12; 3.15.

⁸⁶ *ibid*, para 3.13.

While delivering the decision in *Sequana*, Lord Hodge conceded that ‘...[i]t was unfortunate that time did not permit the CLRSg to consult further and to resolve the differences among its members on the question of a duty in relation to a company’s creditors, particularly in the period as a company nears insolvency.’⁸⁷ He agreed with Lord Briggs that Parliament endorsed the existence of an obligation to have regard to the interests of creditors in the context of the onset of insolvency of a company but left it to the courts to refine the law in this area.⁸⁸ The courts have since applied the creditor duty on a case-by-case depending on the circumstances at hand, including whether the company was potentially insolvent,⁸⁹ on the verge of insolvency,⁹⁰ within the zone of insolvency or insolvent,⁹¹ among other circumstances. Nevertheless, the ruling in *Sequana* provided another opportunity to the courts to clarify this position but it once again failed to do so.

At present, there is no codified directors’ duty to creditors, that is, a duty to promote or protect creditor interests other than an obligation to consider creditors’ interests, which is an aspect of the directors’ duty to act in the best interests of the company under CA 2006, section 172. Yet, a codified duty would help provide clarity and a form of legislative basis for the creditor duty and remedy. Over the years, several justifications, both academic and judicial, have been advanced in support of extending directors’ duties to include creditors’ interests both in a solvent and insolvent states.⁹² These have mainly been premised on the economic impact this would have on both shareholders and creditors as residual risk-bearers. However, there have yet to be a solid step taken by courts to address this concern. Perhaps a look at Canada and Ireland’s approaches to dealing with creditor duty would support the call for a codified creditor duty and remedy.

⁸⁷ *Sequana* (UKSC), at [223].

⁸⁸ *Sequana* (UKSC), at [224].

⁸⁹ *In re Loquitur Ltd* [2003] EWHC 999 (Ch); [2003] 2 B.C.L.C. 422, at [240].

⁹⁰ *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 B.C.L.C. 153, at [74].

⁹¹ *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

⁹² For example, see: Andrew Keay, “The Duty of Directors to Take Account of creditor Interests: Has It Any Role to play?” [2002] JBL 379, 386; Andrew Keay, “The Shifting of Directors’ Duties in the Vicinity of Insolvency” (2015) 24 IIR 140, 145; Kristin van Zwieten, “Director Liability in Insolvency and Its Vicinity” (2018) 38(2) OJLS 382, 389; Rosemary Teele Langford and Ian Ramsay, “The contours and content of the ‘creditors interests duty’” (2021) 21(1) JCLS 85, 88; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722; *Liquidators of West Mercia Safetywear Ltd v Dodd* [1988]; *Bilta (UK) Ltd (In Liquidation) v Nazir* [2015] UKSC 23; [2016] A.C. 1; *System Building Services Group Ltd*, [2020] B.C.C. 345 among others.

4. International best practices

4.1 Canada

Canada is one of the common law jurisdictions where the question of whether directors' fiduciary duties⁹³ to the company include the obligation to consider creditors interests has been debated for decades. Most notably, this question was the subject of deliberations before the Supreme Court of Canada (SCC) in *Trustee of People's Department Stores Inc. v. Wise*,⁹⁴ and *BCE Inc. v. 1976 Debenture holders*,⁹⁵ where the SCC acknowledged that directors owe a duty of care to creditors, but that duty does not rise to a fiduciary duty.⁹⁶ This duty is also given legislative force in the Canadian Business Corporations Act (CBCA) 1985.⁹⁷

The CBCA 1985 also provides a non-exhaustive list of relevant factors to be taken into consideration by directors while undertaking their duty of loyalty to stakeholders. The non-exhaustive list was also afforded legitimacy by the SCC in *Trustee of People's Department Stores Inc v Wise*,⁹⁸ by emphasising that '...[i]t may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment' in assessing whether the directors have acted in the best interests of the corporation.⁹⁹

Although the consideration of this list is non-obligatory on the directors, codification of the list in the CBCA 1985 provides a form of statutory basis for creditors that directors ought to be mindful of in decision making during corporate insolvency. In addition, the CBCA 1985 affords creditors options to pursue a so-called oppressions remedy,¹⁰⁰ and a duty of care-based action remedy.¹⁰¹ The oppression remedy is premised on harm to the legal and equitable interests of a wide range of stakeholders, such as creditors affected by oppressive

⁹³ The fiduciary duty under s. 122(1)(a) of the Canadian Business Corporations Act (CBCA) 1985 requires directors and officers to act in good faith and honestly *vis-à-vis* the corporation.

⁹⁴ [2004] 3 SCR 461.

⁹⁵ [2008] 3 SCR 560

⁹⁶ *Trustee of People's Department Stores Inc v Wise* 2004 SCC 68; [2004] 3 SCR 461, para 1 and *BCE Inc. v. 1976 Debenture holders* [2008] 3 SCR 560, at [5].

⁹⁷ Canadian Business Corporations Act 1985, s. 122 (1.1).

⁹⁸ *Trustee of People's Department Stores Inc v Wise* 2004 SCC 68; [2004] 3 SCR 461.

⁹⁹ *ibid*, at [42] – [47].

¹⁰⁰ CBCA 1985, s. 241(2)(c).

¹⁰¹ CBCA 1985, s. 122(1)(b).

acts of the company or its directors. The court has broader jurisdiction to enforce not just what is legal but what is fair and in the interests of the reasonable expectations of the parties.¹⁰²

Most importantly, where there has been a breach by directors, creditors may obtain leave of court to bring actions, such as derivative claims on behalf of the corporation in certain circumstances where their interests have been handled in a manner that is to their detriment.¹⁰³ Therefore, the position in Canada provides a clearer approach to dealing with the question of creditor duty and available remedies to creditors than is the position in England and Wales and provides an approach that may inform that of England and Wales.

4.2 Ireland

In July 2022, the Republic of Ireland made amendments to its Companies Act 2014 through the passage of the European Union (Preventive Restructuring) Regulations 2022,¹⁰⁴ that transposed the EU Preventive Restructuring Directive (PRD),¹⁰⁵ into Irish domestic law. This was to fulfil the requirement by the PRD for Member States to enact a directors' duty to creditors where there was a likelihood of insolvency.¹⁰⁶ The 2022 Regulations introduced a requirement on company directors to have regard to the creditors of the company where the company was unable, or likely to be unable, to pay its debts as they fell due.¹⁰⁷

Specifically, a new section 244A was inserted into the Irish Companies Act 2014,¹⁰⁸ establishing that a director of a company who believes, or who has reasonable cause to believe, that the company is, or is likely to be unable to pay its debts (within the meaning of section 509(3)), shall have regard to: (a) the interests of the creditors, (b) the need to take steps to avoid insolvency, and (c) the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business of the company.¹⁰⁹ From this passage the creditor

¹⁰² *BCE Inc. v. 1976 Debenture holders* [2008] 3 SCR 560 at [45]; [58] - [59].

¹⁰³ CBA 1985, s.122(1.1) (iv).

¹⁰⁴ Statutory Instrument No. 380/2022. (Hereafter, 2022 Regulations).

¹⁰⁵ Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, amending Directive (EU) 2017/1132.

¹⁰⁶ *ibid*, Chapter 5, Art 19.

¹⁰⁷ Companies Act 2014, s.570 (a) – (c).

¹⁰⁸ Courtesy of Regulation 4, of the 2022 Regulations.

¹⁰⁹ Companies Act 2014, s. 224(A)(1).

duty is engaged where the director has either subjective awareness or reasonable cause to believe that the company is, or likely to be insolvent and sets a mandatory obligation¹¹⁰ on directors to have regard to creditor interests as the likelihood of insolvency is established.

In addition, an objective standard for assessment of the directors' consideration of the creditor duty is established and the criteria or factors that directors must have regard to are established. These are mainly, taking steps to avoid insolvency and protecting corporate viability.¹¹¹ This is in addition to a series of statutorily defined financial situations that would give rise to the creditor duty and requirements upon which a subjective or objective approach to assessing the directors' knowledge of the company's insolvency would be assessed.¹¹²

5. Conclusion

The ruling in *Sequana* has undoubtedly brought some clarity to the creditor duty conundrum within English company law. The creditor duty obligation is now engaged where the company is insolvent or imminently insolvent.¹¹³ Directors must now 'consider' the interests of creditors (alongside those of the members) where a company is insolvent or imminently insolvent. However, directors must 'act in the interests of creditors,' to the exclusion of the members' interests, once insolvent liquidation or administration is inevitable.¹¹⁴

Therefore, this judgement ought to be credited as a precursor to the codification of the creditor duty and creditor remedy. This may be in the form of amending section 172 of the Companies Act 2006 to include a clear statement of creditor duty, its scope and application. In addition, there is the option to make amendments to Part 11 of the Companies Act 2006 (on derivative action), particularly, sections 260 – 269, such that it could be extended to creditors as well. This would mean that creditors could seek leave of court to initiate and/or continue a derivative action to hold directors accountable for breach of duty to the company by failing to observe the creditor duty.

¹¹⁰ The term 'shall' have regard to... under s.244A(1) sets a mandatory obligation to directors to have regard to factors (a) –(c) with the primary factor (a) mainly on creditors' interest.

¹¹¹ Irish Companies Act 2014, s.244A (b) and (c).

¹¹² R Breen, 'An Appraisal of the Director's Duty to Creditors in Ireland' (2022) 29(10) C.L. Pract. 191.

¹¹³ *Sequana* (UKSC) at [46] – [51]; [250], [261].

¹¹⁴ This point was emphasised in *Re Prezzo Investco Ltd* [2023] EWHC 1679 (Ch), at [35] – [37].

As the law recognised the need to provide shareholders avenues through which they can hold directors accountable for breach of duties, creditors also ought to be availed a legislative force as they are one of the key stakeholders in the corporate setting whose interests are impacted upon financial difficulties/corporate insolvency. There may be arguments that where a company is irreversibly insolvent, and therefore, undergoing insolvent liquidation, the appointed officeholder can exercise power to hold directors accountable for their breach of duty and any remedies recoverable is to the benefit of creditors for eventual creditor distributions. However, the counter argument is that these are officeholder actions exercisable at the discretion of the appointed officeholder and are not specifically availed to creditors.

Fortunately, the Supreme Court in *Sequana* made some observations on the similarities between officeholder actions and creditor duty, such as those arising via the insolvency Act 1986,¹¹⁵ but acknowledged that these officeholder actions are engaged during insolvent liquidation proceeding. This leaves a gap in the right of enforcement, especially, in the periods prior to insolvent liquidation during which directors may engage in some form of breach to their duties and/or obligations to the company. Extending the derivative action to creditors would bridge this enforcement gap.

¹¹⁵ *Sequana* (UKSC), per Lord Briggs, at [203], Lord Hodge, at [231]; and Lord Reid, at [94]; [101] respectively.