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Sequana: Supreme clarification on the duty owed to creditors

The Supreme Court has unanimously dismissed the BTI v Sequana appeal and reviewed the existence, content and engagement of the so-called ‘creditor duty’; being the point at which the interest of creditors is said to intrude upon the decision-making of directors of companies in financial distress.

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The ‘creditor duty’ modifies the rule in s172(1) of the Companies Act 2006 which otherwise requires directors to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. It is not a free-standing duty but, when engaged, it requires directors to manage the company’s affairs in a way which takes into account the interests of the general body of creditors, to give appropriate weight to those interests and seeks not to harm those interests. This decision is important as it recognises the relative importance of a creditor’s economic interest in a company and the fact that that economic interest increases where the company is insolvent or bordering on insolvency.

The test of when the ‘creditor duty’ is engaged has been articulated in many different ways. The process of Sequana through the Courts has effectively filtered out some of those colloquialisms. The majority view of the Supreme Court is that the ‘creditor duty’ will be engaged when the directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation or administration is probable. The weight that should then be given to creditors’ interests will depend on the extent of the company’s financial difficulties with those interests achieving paramountcy only if the company becomes irretrievable insolvent.

Progress towards insolvency may not be linear and directors should stay informed of the company’s financial position and the changing emphasis on the interests of creditors in order to react effectively as matters evolve and, in doing so, to protect themselves from personal liability.

For further comment and discussion of the implications of the judgment from our Financial & Professional Risk team, please click here.

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