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The light at the end of the tunnel and the last throw of the die: liquidators' claims against former directors following Sequana

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Do company directors owe a duty to consider the interests of the company's creditors in addition to or in place of their duty to consider the interests of its members? If so, in what circumstances does that duty arise? Both of these questions were considered, for the first time, by the Supreme Court in its landmark judgment in BTI 2014 LLC v Sequana SA & Ors [2022] 3 WLR 709.

The UK's highest court found it necessary to consider the fairly narrow question it had to decide in *Sequana* against the backdrop of similar (or potentially competing) remedies and doctrines in company and insolvency law more broadly. In doing so, it gave valuable guidance as to how directors should conduct themselves when the company they serve strays towards insolvency if they wish subsequently to avoid liability.

This article considers the effect of the decision and reasoning in *Sequana* on claims which liquidators may seek to bring against former directors for (a) wrongful trading under section 214 of the Insolvency Act 1986 ("IA 1986") and (b) misfeasant trading in breach of their duties which, where the company has gone into liquidation, might be brought under IA 1986, section 212. It touches upon the ongoing BHS litigation, in which the liquidators of the BHS companies are bringing claims under sections 212 and 214 against some of BHS's former directors.

The "creditor duty" – the issue in Sequana

The starting point in *Sequana* was the statutory duty under section 172(1) of the Companies Act 2006 ("CA 2006"), which requires a director to "*act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole*" and in doing so to have regard in particular to various matters set out in the statutory provision (including the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, etc). Under CA 2006, section 172(3), that duty "*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*".

In *Sequana*, the directors of a non-trading company had caused it to pay a dividend of €135m to its parent company and sole shareholder. The company was solvent at the time the dividend was paid but had some uncertain long-term contingent liabilities which gave rise to a "*real risk*" – though not a probability – that it might become insolvent at some time in the future. Some ten years later, the company went into insolvent administration.

Prior to entering administration, the company brought proceedings against its directors seeking an amount equivalent to the €135m dividend for breach of section 172(3) on the basis that that section preserved a common law rule that, in some circumstances, directors are under a duty to have regard to the interests of the company's creditors as a whole.

Specifically, the claimant (to whom the claim

had been assigned) argued in the Supreme Court that this "creditor duty" is a duty owed to the company which arises where the company is solvent but there is a real, but not remote, risk of it becoming insolvent at some point in the future. The nature of the duty, the claimant argued, was to have regard to the interests of the creditors – unless the company was actually insolvent, in which case, it contended, the duty was one to treat the creditors' interests as paramount.

The Supreme Court concluded that there is a "creditor duty" at common law (albeit that Lord Reed deprecated the use of the shorthand term "creditor duty" on the basis that it wrongly implies that the duty is a freestanding duty rather than being simply an aspect, when it is triggered, of the director's fiduciary duty to the company). It also concluded, with relative ease, that the "creditor duty" was not engaged in *Sequana* itself because a "*real risk*" of insolvency was not enough to trigger that duty. This was sufficient to dismiss the appeal.

The issues of when the duty would be triggered and the nature of the duty once triggered proved more divisive. Though it was not necessary to decide the case before them, the Supreme Court offered some views as to the answers to these questions.

"No light at the end of the tunnel" – wrongful trading liability under IA 1986, section 214

In their respective judgments analysing the "creditor duty", Lord Reed PSC, Lord Briggs JSC (with whom Lord Kitchin JSC agreed), Lord Hodge DPSC and Lady Arden JSC all referred to IA 1986, section 214. All four recognised that it would be undesirable for any "creditor duty" to conflict with the existing statutory regime for wrongful trading. They also recognised that section 214 specifies its own trigger point and is therefore a useful point of reference when analysing what the trigger point is for the "creditor duty" at common law.

Section 214(2)(b) provides that the trigger point for potential wrongful trading liability is: "*at some time before the commencement of the winding up of the company,* [a person who is or has been a director of the company] *knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation*".

As Lord Briggs explained, at [124], it is the company's prospect of avoiding insolvent *liquidation* (or administration) which forms the touchstone for liability under section 214, not its prospect of avoiding *insolvency*. Insolvency, as Lord Briggs observed at [120], whether balance sheet insolvency or commercial insolvency, is not necessarily permanent or fatal to the success of a company; indeed, many start-up companies are balance sheet insolvent while their products are being developed and yet go on to be spectacularly successful – and their shareholders very wealthy – later down the line.

Where the directors see a reasonable prospect that the company will be able to trade out of insolvency, they see, in Lord Briggs' phrase, "*light at the end of the tunnel*". No wrongful trading claim can arise in those circumstances.

The Supreme Court plainly considered that a company would have to be in very dire straits for there to be "no light at the end of the tunnel" for the purposes of section 214. Lords Reed and Briggs and Lady Arden all glossed the test in section 214(2)(b) as requiring knowledge that a liquidation or administration has become **inevitable** (at [98], [124], [172] and [321]). Lord Hodge referred to the need for "irretrievable insolvency" so as to give rise to liability under section 214 (at [239]). Knowledge on the part of directors that an insolvent liquidation or administration is probable (i.e. more likely than not) is not sufficient (see Lord Briggs' judgment, at [203]).

As to the implications of this for the timing and nature of the "creditor duty", Lords Briggs and Hodge observed (at [172], [176] and [247]) that it should only become a duty to treat the creditors' interests as **paramount** at the point at which liquidation or administration has become

inevitable – i.e., at the same point as liability under section 214 could be triggered. Otherwise, section 214 would appear to be rendered otiose because the directors would already have become liable to the company for breach of the "creditor duty" at some earlier date than the trigger point provided for in that section (judgment of Lord Briggs, at [172]). Lady Arden made similar comments at [311].

Conversely, for the "creditor duty" to add anything to section 214, it would need to come into effect – albeit to a lower standard than consideration of creditors' interests as "*paramount*" – at some earlier point in time than the trigger point for section 214.

Provisional conclusions on the timing and nature of the "creditor duty"

As to when the "creditor duty" will be triggered, Lord Briggs' formulation, with which Lords Kitchin and Hodge agreed, is as follows: "*either imminent insolvency (i.e. an insolvency which the directors know or ought to know is just around 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*" (at [203] and [227]). In their assessment, therefore, the directors' knowledge of either the imminent insolvency or the probability of insolvent liquidation is a key element of the trigger (as it is under section 214).

Lord Reed preferred to formulate the trigger point as one where the company is "*insolvent or bordering on insolvency*", and also (in agreement with Lords Briggs and Hodge) where an insolvent liquidation or administration is probable, but he was not prepared to express a concluded view that it is essential that the directors know or ought to know that the company is bordering on insolvency, is insolvent or that an insolvent liquidation or administration is probable (at [88]-[90]).

As to the nature or content of the "creditor duty" prior to the section 214 trigger point being reached, Lords Briggs, Reed, Hodge and Kitchin suggested that it is "*a duty to consider creditors' interests, to give them appropriate weight, and to balance them against shareholders' interests where they may conflict*" (at [176]).

Lady Arden, by contrast, contended for a duty "*to consider creditors' interests at all material times and not to harm their interests*" (at [288]).

The "last throw of the die": a narrow space for section 212 "misfeasant trading" claims?

IA 1986, section 212 does not create new liabilities or obligations, but rather offers a simplified procedure in the course of a liquidation for the recovery of property or compensation that would otherwise be recoverable by way of claims at common law or in equity. It includes "*misfeasance or breach of fiduciary or other duty in relation to the company*" by former directors and is therefore commonly relied on by liquidators when bringing claims during the course of a company's winding up. In particular, it is common for a wrongful trading claim under section 214 to be coupled with a "misfeasant trading" claim under section 212. The liquidators of the BHS companies, for example, have taken this approach in the BHS litigation which is currently making its way through the courts (see *Chandler v Wright* [2022] Bus LR 1510).

A "misfeasant trading" claim brought under the umbrella of section 212 comprises allegations that (i) the directors owed a duty (the "creditor duty" under CA 2006, section 172) to consider the creditors' interests and give them appropriate weight and (ii), in breach of that duty, the directors continued to trade the company past the point at which they should have caused it to be wound up or put into administration.

It is a necessary prerequisite for such a claim not only that the directors owed a duty to **consider** the creditors' interests and balance them against the shareholders' interests, but that in the circumstances of the case the "creditor duty" required them to **prioritise** the creditors'

interests over those of the shareholders. Otherwise, causing the company to continue to trade would not constitute a breach of duty; it is difficult to think of any circumstances in which continuing to trade, however riskily, would prejudice the **shareholders**, who stand to gain nothing once the company goes into liquidation but have every chance of gain if it manages to trade its way out of insolvency. However, any duty to **prioritise** the creditors' interests must arise **before** the time when their interests become paramount, i.e. at the "trigger point" for a section 214 claim, otherwise (as discussed above) a section 212 claim adds nothing to a section 214 claim.

In his judgment, Lord Hodge considered a set of circumstances, prior to the point of inevitable insolvent liquidation, in which the "creditor duty" might be triggered and have the effect of requiring the directors to prioritise the creditors' interests over those of the shareholders (at [238]). The circumstances he posited were that: the directors know or ought to know that an insolvent liquidation is probable; but it could be avoided if the company were to undertake a particularly risky transaction; albeit one which, if it were to fail, would result in the company's assets being lost to creditors. In other words, a situation where the directors have a "*last throw of the die*" (at [245]). In Lord Hodge's view, depending on the individual circumstances, the "creditor duty" might require the directors not to throw that last die.

Lord Hodge observed that it might only be in "*such extraordinary circumstances*" that there would be a remedy for breach of the "creditor duty" in circumstances arising before the irretrievable insolvency that might gave rise to liability under section 214. The message appears to be that the scope for claims for breach of the "creditor duty", whether or not brought under the umbrella of section 212, is very narrow indeed.

Conclusion

While a great deal has been left undecided, *Sequana* provides a much-needed insight into the approach the courts can be expected to take to liquidators' claims against former directors in the future.

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