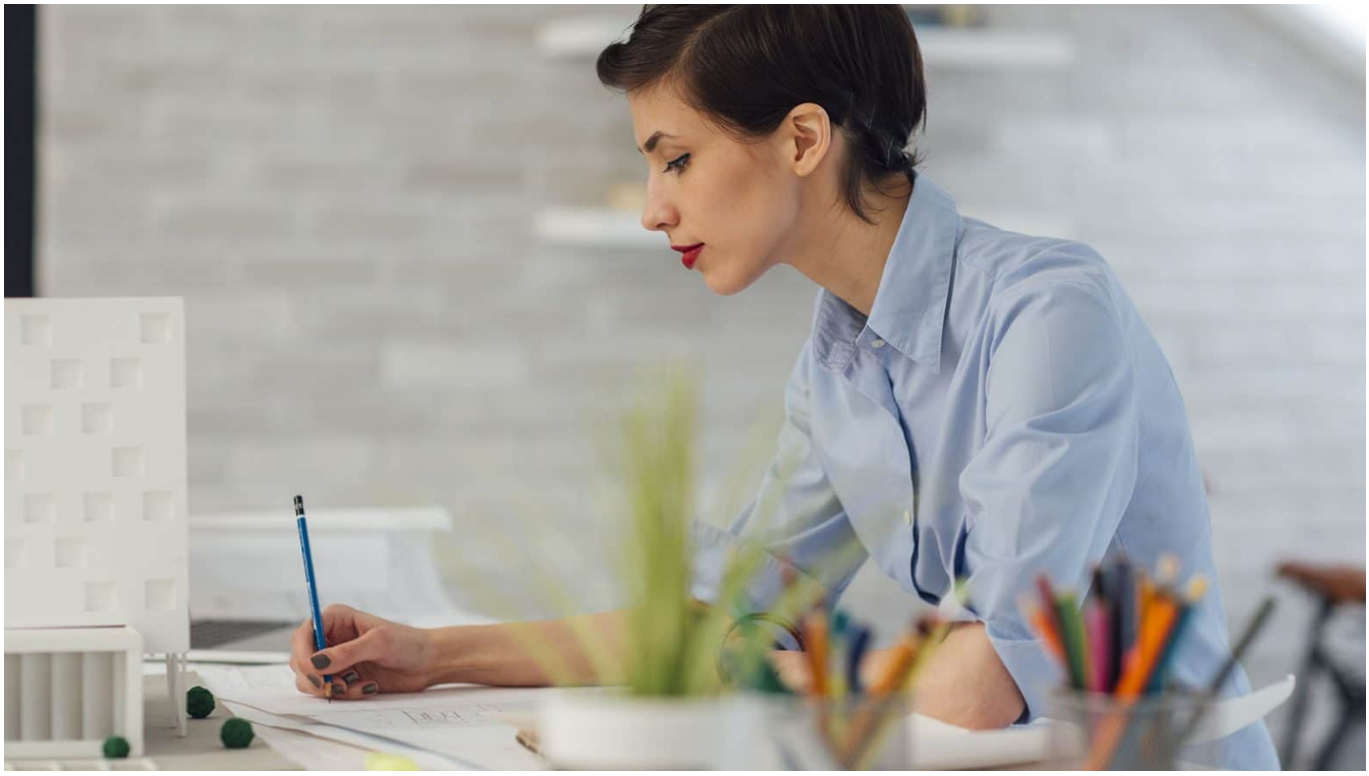
Sequana – problem solved?



As discussed in my previous blog the Supreme Court judgment in *BTI 2014 LLC v Sequana SA and others [2022] UKSC* ("Sequana"), has been eagerly awaited by the insolvency industry. The wait is finally over, with the Supreme Court producing a 160 page judgment on 5 October 2022.

The key question the court was asked to consider was when and in what circumstances the duty of directors under section 172 of the Companies Act 2006 (the "Act") to promote the success of the company for the benefit of its members becomes one that must have regard to the interests of creditors ("the creditors' interests duty").

Briefly, Sequana relates to a decision by a company to pay substantial dividends to its majority shareholder at a time when it had an unquantifiable contingent liability and therefore risked insolvency, although at the time it was not insolvent.

The answers we do have

The Supreme Court determined that:

1. There is a common law creditors' interest duty;
2. The creditors interest duty can apply to an otherwise lawful decision by the directors to pay a dividend; and
3. The creditors interest duty arises when directors know or ought to know that the company is insolvent or bordering insolvency or a formal liquidation / administration is probable.

What's missing?

The court ruled that the creditors' interest duty was not engaged on the facts of Sequana. This is because, at the time the dividend in question was paid, the company was not actually or imminently insolvent. There might have been a real risk of insolvency but this was not sufficient to trigger the creditors' interest duty in that case.

The majority of the Supreme Court determined that the creditors interest duty would be triggered if the directors knew, or ought to have known, that the company was insolvent or bordering insolvency. The minority agreed that the duty applies when the company is insolvent or bordering insolvency, however, they left open the question as to whether it is essential for the directors to know (or ought to have known) that this is the case.

Generally speaking, a lot of the judgment is *obiter* raising the question of which parts are actually binding. We would suggest the points listed at 1-3 above are now binding authority with the issue of directors' knowledge one that remains unanswered.

Key takeaways

The judgment highlights the policy considerations relevant when assessing whether the creditors interest duty has arisen, and when it should be paramount over shareholders' interests. The Supreme Court discussed the need not to squash entrepreneurialism and stated that whether the creditors interest duty has arisen will be very fact specific. It is helpful to think of the solvency (and insolvency) of a company as a sliding scale, which is not linear, meaning that whilst a company may be temporarily insolvent (on a cash flow basis) it may not meet the threshold (see point 3. above) set out in Sequana.

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