

2023

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Recommended Citation

Quinn, John and Gavin, Philip, "The Creditor Duty Post Sequana: Lessons For Legislative Reform" (2023).
Articles. 47.

<https://arrow.tudublin.ie/aaschlawart/47>

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Funder: This research received no external funding

THE CREDITOR DUTY POST *SEQUANA*: LESSONS FOR LEGISLATIVE REFORM

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Abstract: UK common law recognises that directors owe a fiduciary duty to consider creditors’ interests when a company is insolvent or in financial difficulty. However, the scope of the duty was unclear, particularly the degree of financial difficulty necessary for it to arise. In 2022, in *BTI v Sequana*, the Supreme Court delivered its 160-page judgment on the creditor duty. The court rejected the “real risk of insolvency test” and refrained from setting criteria for when the duty would arise. The court instead retained the traditional common law position of a context first approach, where the duty’s triggering point is based on the facts and the risk to creditors rather than by reference to technical definitions of insolvency or strict legal standards. In contrast, Ireland codified its creditor duty in 2022, setting out a series of legislatively defined financial situations where the duty applies. Given that *BTI v Sequana* added little certainty to the area, a question emerges about the potential benefits of a UK codification of the duty. Codification promises certainty for directors, yet this area of law is notoriously complex and codification risks both directors and courts focusing their decision making on technical definitions rather than by reference the overall business context. This article argues that while a search for complete doctrinal certainty is misguided, a degree of certainty over and above the position in *Sequana* can be achieved and that Ireland’s codification offers valuable lessons for future UK law reform.

KEYWORDS: Creditor Duty, *BTI v Sequana*, Directors’ Duties

INTRODUCTION

When a company is in financial difficulty a divergence often emerges between what is in the interests of the company and its shareholders and what is in the interests of the creditors.¹ Because shareholders receive nothing in an insolvent liquidation, their interests lie in a return

* The authors would like to thank the reviewers for their insightful feedback. We would also like to thank Dr Jonathan Hardman and the participants of the Society of Legal Scholars “Future of Company Law” conference at the University of Edinburgh where an earlier draft of this article was presented.

¹ For a detailed, cross jurisdictional analysis of this issue see A. Aurelio Gurrea-Martínez, “Towards an Optimal Model of Directors’ Duties in The Zone of Insolvency: An Economic and Comparative Approach” (2021) 21(2) *Journal of Corporate Law Studies* 365.

to solvency. Management, who prioritise shareholders, may therefore continue trading and engage in high-risk strategies² which have significant upside potential but little or no downside risk as creditors bear the cost of a depletion of funds prior to liquidation. A further problem, evident in the case law, is directors dissipating company assets on the eve of liquidation to either themselves³ or related parties⁴, reducing what is available to distribute to creditors on liquidation. To offset these “perverse incentives”⁵, English common law requires directors of companies in financial difficulty to consider the interests of creditors.⁶

Unlike the other fiduciary duties owed by directors, the creditor duty was not codified in the UK Companies Act 2006 (UK 2006 Act).⁷ While it was originally intended for the duty to be codified⁸, it was excluded at the final stage. The Government at the time preferred for the duty to continue its development at common law⁹, a decision which seemed reasonable given its relatively complex nature. While most directors’ duties are focused on internal matters and are ongoing obligations throughout the company’s life, the creditor duty focuses on external parties and arises only at financial difficulty. This presents the difficult questions of the degree of financial difficulty necessary for the duty to be triggered¹⁰ and whether the director needs to be subjectively aware of those financial difficulties. Another unresolved question is what the duty actually requires from directors. While dissipating assets immediately prior to liquidation breaches the duty¹¹, it is not clear how directors should balance the competing interests of shareholders and creditors. English common law dealt with these complexities by taking a case-by-case approach, where a company’s specific financial situation and the risk borne by creditors formed the basis as to whether the duty was triggered and breached. Hence, English cases applied the duty when the company was insolvent¹², “on the verge of insolvency”¹³ or

² The incentive to do so may be particularly strong in private companies where directors are also shareholders.

³ For example, *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722.

⁴ Such as connected companies in a corporate group as was the case in the Irish Supreme Court case of *Re Frederick Inns Ltd* [1994] I.L.R.M. 387. See also *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

⁵ As they have become known in the literature: D. Prentice, “Creditors’ Interests and Directors’ Duties” (1990) 10 *Oxford Journal of Legal Studies* 265; N. Ruben, “Duty to Creditors in Insolvency and the Zone of Insolvency: Delaware and the Alternatives” (2010) 7 *New York University Journal of Law & Business* 333; P. Davies, “Directors’ Creditor-Regarding Duties in Respect of Trading Decision Taken in the Vicinity of Insolvency” (2006) 7 *European Business Organisation Law Review* 301.

⁶ See *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30; *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 B.C.L.C. 153; *Re MDA Investment Management Ltd* [2005] B.C.C 783.

⁷ The UK 2006 Act did acknowledge the existence of the creditor duty. S.172(3) states “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.”

⁸ Modern Company Law for a Competitive Economy: Final Report (2001), [3.17].

⁹ The explicit rationale for not codifying the creditor duty was that it would require directors to make finely balanced judgments around insolvency and may undermine the Government’s attempts to promote and facilitate a rescue culture. See, White Paper, *Modernising Company Law* (Cm 5553-1) [3.11].

¹⁰ See A. Keay, “The Director’s Duty to take into Account the Interests of Company Creditors: When is it Triggered?” (2001) 25 *Melbourne University Law Review* 315.

¹¹ See *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

¹² *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

¹³ *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 B.C.L.C. 153 [74].

“potentially insolvent”¹⁴ depending on the facts of the case and the levels of risk borne by creditors. Codifying the duty could undermine this fact first approach and included a risk of creating an overly prescriptive duty that discouraged reasonable attempts to trade out of financial difficulty.

In light of two major developments in 2022, this article re-examines the issue of codification of the creditor duty. In October 2022, the UK Supreme Court delivered its 160-page judgment in *BTI 2014 LLC v Sequana (Sequana)*, the issue on appeal being the appropriate trigger point of the creditor duty. The Supreme Court rejected the contention that the duty was triggered where there was a “real risk of insolvency” but declined to develop any criteria for when the duty would arise. The court also declined to determine if a director’s subjective knowledge of the company’s financial difficulty was a pre-requisite for the duty’s application. In effect, the court retained the common law’s context first approach but did little to add clarity to the area and provided no general guidance for directors of financially distressed companies. Shortly before *Sequana*, in July 2022, Ireland introduced the European Union (Preventive Restructuring) Regulations 2022¹⁵ (Irish Regulations) which amended the Irish Companies Act 2014 (Irish 2014 Act) to require company directors to have regard to creditors when the company is unable, or likely to be unable, to pay its debts. Prior to the reform, the Irish and UK positions on the creditor duty were ostensibly identical.¹⁶ However, in direct contrast to *Sequana*, the Irish Regulations introduced a series of statutorily defined financial situations which gives rise to the duty and clarified the requirement for subjective knowledge of the company’s insolvency.¹⁷ Hence, the Irish Regulations have introduced a degree of certainty in the application of the creditor duty, particularly in relation to when the duty is triggered.

While the obvious criticism of *Sequana* is its failure to provide clarity, this article argues that to search for complete doctrinal certainty in this area of law is misguided. A degree of flexibility must be allowed for courts in specific cases to analyse the facts, the financial situation of the company and the degree of risk to creditors created by the directors decision. Any codification would have to leave scope for such case-by-case assessments to take place. Nevertheless, we argue that a degree of certainty over and above the position in *Sequana* can be achieved, that this is desirable and that the Irish codification can offer insights on how it could be achieved. [This](#)

While the development of the creditor duty in the UK has long been influenced by other

¹⁴ *In re Loquitur Ltd* [2003] EWHC 999 (Ch); [2003] 2 B.C.L.C. 422, [240].

¹⁵ Statutory Instrument No. 380/2022.

¹⁶ Several Irish cases stated that a duty existed, the leading case being *Re Frederick Inns Ltd* [1994] I.L.R.M. 387 but the case law provided little guidance for when the duty would arise or what it required. Again, as in the UK, the creditor duty was omitted from the general codification of directors’ duties in s.228 of the Irish 2014 Act.

¹⁷ Under Irish common law, the creditor duty applied only to directors who were subjectively aware of the company’s insolvency. See *Parkes v Hong Kong & Shanghai Bank Corp* [1990] I.L.R.M. 341 and *Re DSC Ltd* [2006] IEHC 179 discussed below.

common law jurisdictions, most notably by judgments in Australia¹⁸ and New Zealand¹⁹, this article focuses on Ireland as a comparator jurisdiction given its almost identical common law history and recent codification which has the potential to inform potential legislative reform in the UK. This article also focuses primarily on the trigger point of the duty given the importance of establishing when the duty applies and because it was the explicit issue to be decided in *Sequana*. Moreover, the new enacted legislative trigger to the creditor duty is where the Irish Regulations deviate most from the common law position, therefore representing the most insightful point of comparison for future UK reform. The article does address other matters related to the content of the duty but certain issues raised by *Sequana*, such as what it means to treat creditors as a general body and shareholder ratification are not discussed due to space constraints and because they are not clarified to any meaningful degree in the Irish codification. The article proceeds in four parts. Part one sets out the history of the duty at common law. Part two discusses the issue of codification. Part three describes recent developments in the area, setting out the key points of the *Sequana* judgment and the Irish Regulations. Part 4 provides analysis and advances the article’s main argument.

1. THE COMMON LAW DUTY

When a company is solvent, a director’s primary duty is to act, in good faith, in the interests of the company.²⁰ Under the UK 2006 Act, this means promoting “the success of the company for the benefit of its members” while having regard to other, more socially oriented factors.²¹ In Ireland, the phrase acting in the interests of the company has also been interpreted to mean the interests of shareholders,²² although the Irish 2014 Act is largely²³ silent on the point.²⁴ On liquidation, a liquidator also owes their duties to the company but their primary responsibility is to ensure that as many assets as possible are available for a distribution to creditors. Between these two points, where the company is, or close to, insolvent but prior to liquidation, multiple common law jurisdictions held that the fiduciary obligations of directors shift toward

¹⁸ *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722.

¹⁹ *Nicholson v Permakraft (NZ) Ltd* (1985) 3 A.C.L.C. 453.

²⁰ S.172(1) of the UK 2006 Act and S.228(1)(A) of the Irish 2014 Act.

²¹ S.172(1) of the UK 2006 Act known as Enlightened Shareholder Value. See A. Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2012).

²² The leading Irish case where this interpretation was adopted is *G&S Doherty v Doherty* (19 June 1969) where Henchy J. stated that “directors are in a fiduciary position, and must exercise their power *bona fide* for the benefit of the company as a whole, that is to say, the shareholders as a whole” at 22. Courtney believes this is the correct interpretation of the phrase in the context of private companies. T. Courtney, *The Law of Companies* (4th edn. Bloomsbury 2016), [16.043].

²³ The Companies Act 2014 does discuss the interests of shareholders but this arises only as a factor to which directors must have regard alongside the interests of employees. See, Irish 2014 Act s.224.

²⁴ It is worth noting that the phrase can be interpreted differently, as a duty to act in the company’s interests as a separate entity, which may result in prioritising interest groups other than shareholders. This line of thinking is usually directed at larger, public companies where those companies have a significant societal impact. See B. Sjøfjell, A. Johnston, L. Anker-Sørensen, D. Millon, “Shareholder Primacy: The Main Barrier to Sustainable Companies” in B. Sjøfjell and B.J. Richardson (eds) *Company Law and Sustainability: Legal Barriers and Opportunities* (CUP 2015), 89-101.

creditors.²⁵ The rationale for the creditor duty is that while voluntary creditors are protected by contract²⁶, the protections afforded by legal personality and limited liability mean creditors warrant additional fiduciary protection when a company is in financial difficulty.²⁷ Because shareholders receive nothing in an insolvent liquidation, their interests lie in the company returning to solvency and directors, who prioritise shareholders, may therefore continue trading and engage in high-risk strategies.²⁸ However, while a return to solvency would also benefit creditors, they bear the cost of a depletion of funds prior to liquidation and so their interests may be better served by preserving assets for distribution. A further problem, prevalent in the case law, is directors dissipating company assets on the eve of liquidation to either themselves²⁹ or related parties.³⁰ Hence, the creditor duty reflects the fact that when a company is in financial difficulty, it may no longer be appropriate for directors to prioritise the interests of the company and its members as it is the creditors who bear the risk of the directors' decision making.

The seminal case is *Walker v Wimborne*,³¹ a High Court of Australia case where misfeasance proceedings were taken by a liquidator against the directors of several companies in a corporate group. The directors had moved funds from one company, Asiatic Electric Co Pty Ltd (Asiatic), to other companies in the group at a time when Asiatic was insolvent. The court held that the movement of funds was made in total disregard of Asiatic's creditors and breached the directors' duties to creditors.³² Mason J. stated "it should be emphasized that the directors of a company in discharging their duty to the company must take account the interest of its shareholders and its creditors".³³ Another influential Australian case is *Kinsela v Russell Kinsela Property Ltd*³⁴ from the New South Wales Court of Appeal.³⁵ The case involved the grant of a lease of company property to two directors at an undervalue at a time when the company was in financial difficulty. The lease also included an option to purchase the property at a price significantly below its market value. Soon after granting the lease, the company entered liquidation and the liquidator sought to set aside the lease on the grounds that it was

²⁵ See, for example, *Walker v Wimborne* (1976) 137 C.L.R. 1; *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722; *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30 and *Re Frederick Inns Ltd* [1994] I.L.R.M. 387. Other areas of law also attempt to address this issue, for example Wrongful Trading under s.214 of the Insolvency Act 1986 and Reckless Trading under s.610 of the Irish 2014 Act.

²⁶ There are shortcomings in these contractual solutions such as informational asymmetries about the true risk involved and differentials in bargaining power which may not facilitate the taking of security. For a full exploration see A. Keay, "A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach" (2004) 4(2) *Journal of Corporate Law Studies* 307, 319-326.

²⁷ See, A. Keay, "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Overprotection of Creditors" (2003) 66(5) *Modern Law Review* 665.

²⁸ The incentive to do so may be particularly strong in private companies where directors are also shareholders.

²⁹ For example, *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722.

³⁰ Such as connected companies in a corporate group as was the case in the Irish Supreme Court case of *Re Frederick Inns Ltd* [1994] I.L.R.M. 387. See also *West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30.

³¹ (1976) 137 C.L.R. 1.

³² *Ibid*, [15].

³³ *Ibid*, [13].

³⁴ [1986] 4 N.S.W.L.R. 722.

³⁵ For a detailed comparison between the UK and Australia in this area of law see R.T. Langford and I. Ramsay "The Contours and Content of the 'Creditors' Interests Duty" (2021) 21(1) *Journal of Corporate Law Studies* 85.

made in breach of the directors' duties. Street C.J. held that the purpose of the transaction was to put a company asset beyond the reach of creditors and was made in breach of their duties to creditors.³⁶

The leading UK authority is the Court of Appeal case *West Mercia Safetywear Ltd v Dodd*.³⁷ The respondent was a director in two companies, West Mercia Safetywear Ltd and A.J. Dodd Ltd. Both companies were in financial difficulty. A.J. Dodd Ltd had a significant overdraft on its bank account but was owed £30,000 by West Mercia Safetywear Ltd. A few days prior to the meetings which ultimately led to the liquidation of both companies, the respondent transferred £4,000 that was paid to West Mercia Safetywear Ltd to A.J. Dodd Ltd's overdrawn account. The liquidator of West Mercia Safetywear Ltd sought repayment of the £4,000 from the bank. The bank refused and the liquidator initiated proceedings claiming that the respondent was guilty of misfeasance and in breach of duty by transferring the £4,000 on the eve of liquidation. The court agreed with the liquidator, Dillon L.J. citing the well-known dicta of Street C.J. *Kinsela* that the insolvency of a company means that the creditors are entitled to "displace the power of the shareholders and directors to deal with the company's assets".³⁸

The leading Irish authority is the Supreme Court's decision in *Re Frederick Inns Ltd*.³⁹ The case involved a corporate group with several companies in the group owing debts to multiple creditors including Revenue. The directors of the companies sold assets belonging to certain companies in the group to pay the tax liabilities not only of those companies, but of several other companies in the group. The result was that the tax debts of the group as a whole were prioritised over the debts of individual companies to their creditors. In the High Court Lardner J. stated that the payments to Revenue were made "in breach of the duty which the company *and the directors* owed to the general creditors of these insolvent companies".⁴⁰ Revenue appealed to the Supreme Court which upheld the decision, citing with approval the judgment of Street C.J. in *Kinsela*.⁴¹ Blayney J., in delivering the judgment of the Supreme Court, stated "[o]nce the company clearly had to be wound up and its assets applied *pro tanto*

³⁶ *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722, 730.

³⁷ (1988) 4 BCC 30. Davies notes that the case is the clearest recognition of the creditor duty in English law P. Davies, *Gower's Principles of Company Law* (6th edn, Sweet and Maxwell 1997), 603.

³⁸ *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722, 730 "In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise.....But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration." *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722, 730.

³⁹ [1994] I.L.R.M. 387.

⁴⁰ [1991] I.L.R.M. 582, 589.

⁴¹ *Re Frederick Inns Ltd* [1994] I.L.R.M. 387, [46].

in discharge of its liabilities, the directors had a duty to the creditors to preserve the assets to enable this to be done, or at least not to dissipate them”.⁴²

The Irish common law duty applied only to directors who were subjectively aware of the company’s insolvency. In *Parkes v Hong Kong & Shanghai Bank Corp*⁴³ the Irish High Court declined to hold a director in breach of their duties because there was no evidence that the director knew the company was insolvent.⁴⁴ MacMenamin J. in *Re DSC Ltd*⁴⁵ reached a similar conclusion regarding the prerequisite of subjective knowledge of insolvency. He stated that “[t]here can be little doubt therefore that amongst the important duties of directors is one to ensure that when *it becomes clear* that a company is insolvent, the assets are preserved and dealt with in accordance with the requirements of the Companies Acts”.⁴⁶

A major point of uncertainty across common law jurisdictions was when the duty arose - was it triggered only on insolvency and how was that to be determined, or did it arise prior to insolvency, when the company was approaching insolvency or simply when in financial difficulty.⁴⁷ The prevailing approach of common law courts, particularly in England, was to apply the duty when it was clear from the facts that the creditors’ finances were being put at risk, rather than a strict legal or accounting based definition of insolvency.⁴⁸ Hence, several English cases recognised a duty to consider the creditors interests even prior to insolvency⁴⁹ including when the company was “bordering on insolvency”,⁵⁰ “on the verge of insolvency”⁵¹ or “potentially insolvent”.⁵² For example, in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* the English High Court held “Where a company is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors' money which is at risk the directors, when carrying out their duty to the company, must consider the interests of the

⁴² Ibid, [38]. More recently, Clarke J. in *Hughes v Hitachi Koki Imaging Solutions Europe* [2006] 3 I.R. 457 regarded *Re Frederick Inns Ltd* as authority for the proposition that directors owe a duty to the creditors on insolvency to preserve the assets so as to enable them to be applied in discharge of the company’s liabilities.

⁴³ [1990] I.L.R.M. 341.

⁴⁴ Blayney J. contrasted the case with *West Mercia Safetyware Ltd v Dodd* where the director knew of the company’s insolvency: “the defendant in the *West Mercia* case was aware that the company whose money he transferred was insolvent whereas, in the present case, there is no evidence that [the defendant] knew the claimant company was insolvent”, 349.

⁴⁵ [2006] IEHC 179.

⁴⁶ Ibid, [35] emphasis added.

⁴⁷ For example, the New Zealand Court of Appeal held in *Nicholson v Permakraft (NZ) Ltd* (1985) 3 A.C.L.C. 453, 459 that “creditors are entitled to consideration, in my opinion, if the company is insolvent, or near insolvent, or of doubtful insolvency, or if a contemplated payment or other cause of action would jeopardise its solvency”.

⁴⁸ In *Kinsela*, Street C.J. refused to “formulate a general test of the degree of financial instability which would impose upon directors an obligation to consider the interests of creditors” *Kinsela v Russell Kinsela Property Ltd* [1986] 4 N.S.W.L.R. 722, 733

⁴⁹ For example, *Re Horsely & Weight Ltd* [1982] 3 ALL ER 1045; *Ultraframe (UK) Ltd. V Fielding* [2005] EWHC 1638; *Brady v. Brady* [1988] 3 B.C.C. 535.

⁵⁰ *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23 [123].

⁵¹ *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 B.C.L.C. 153 [74].

⁵² *In re Loquitur Ltd* [2003] EWHC 999 (Ch); [2003] 2 B.C.L.C. 422 [240].

creditors”.⁵³ A similar judgment was given in *Ultraframe Ltd. v Fielding*⁵⁴ where it was held that “when a company, whether technically insolvent or not, is in financial difficulties to the extent that its creditors are at risk, the duties which the directors owe to the company are extended so as to encompass the interests of the company’s creditors”.⁵⁵

These cases appear to provide an exceedingly broad set of situations where the duty would apply. However, to focus on insolvency or some specific point of financial difficulty as the basis for the duty’s application is mistaken, the common law courts applied the duty based on an assessment of risk given the facts of the case.⁵⁶ Grantham puts it as follows: “the question posed by the court is not simply whether the company is insolvent, but that given the distribution of risk does it continue to be appropriate to regard the interests of shareholders as exclusively reflecting the corporate interest”.⁵⁷ This approach reflects the underlying purpose of the creditor duty, namely that, depending on the decision and the financial position of the company, it may be the creditors that are bearing the risk of the directors’ decision making. Common law courts, particularly in England, took the view that the duty should not arise based on technical accounting or legal definitions of insolvency but rather by a broader contextual understanding of the company’s financial situation including its outstanding liabilities, overall risk and potential to generate income.

2. The Difficulties of Codification

Codification of directors’ duties has become the rule rather than the exception.⁵⁸ Yet, when undergoing the general codification of directors’ duties, both the UK and Ireland omitted the creditor duty. One explanation for the omission is that the creditor duty has a different, more complex character to the more traditional duties of a director such as the duties to avoid conflicts of interest⁵⁹ and to act with care, skill and diligence.⁶⁰ Most fiduciary duties are aimed at reducing agency costs⁶¹, requiring directors to subordinate their personal interests in favour of furthering the interests of the company or its shareholders. However, the creditor duty is focused outward, attempting to limit harm to parties external to the company and does not arise until the company enters financial difficulty. This presents the difficult question of degree of

⁵³ [2003] 2 B.C.L.C. 153, [74].

⁵⁴ [2005] EWHC 1638.

⁵⁵ A similar statement can be seen in *Re MDA Investment Management Ltd* [2005] B.C.C 783 where Park J. stated the duty arose where the company, "whether technically insolvent or not, is in financial difficulties to the extent that its creditors are at risk.", 805.

⁵⁶ D.W. McKenzie-Skene, “Directors’ Duty to Creditors of a Financially Distressed Company: A Perspective from Across the Pond” (2007) 1(2) *Journal of Business Law and Technology* 499, 507-510.

⁵⁷ R. Grantham, “The Judicial Extension of Directors’ Duties to Creditors” (1991) *Journal of Business Law* 1, 15.

⁵⁸ See the extensive list of directors’ duties in s.172-178 of the UK 2006 Act and s.228 of the Irish 2014 Act. For an overview into codification efforts, see Deirdre Ahern, ‘Directors’ Duties, Dry Ink and the Accessibility Agenda’ (2012) 128 *Law Quarterly Review* 114.

⁵⁹ S.174 of the UK 2006 Act and s.228(f) of the Irish 2014 Act.

⁶⁰ S.175 of the UK 2006 Act and s.288 (g) of the Irish 2014 Act.

⁶¹ For an economic analysis of agency costs see E. Fama and M. Jensen, ‘Separation of Ownership and Control’ (1983) 26 *Journal of Law and Economics* 327.

financial difficulty is necessary for the duty to be triggered. There is a further problem of what the content of the duty should be. Dissipating assets on the eve of liquidation should obviously be contrary to a director's duties, yet beyond that specific example, it is not clear what should be required from directors. Are they expected to become more conservative when their company is in financial difficulty, foregoing normal commercial risk taking in order to preserve company assets? The complex nature of the creditor duty is amplified by the fact that it is a comparatively recent development. Many of the now codified duties in the UK and Ireland have a much longer common law history, where there has been more time for judicial development.⁶²

These complexities mean that any codification of the creditor duty would have to strike a delicate balance. A legislative duty could be too prescriptive, discouraging reasonable efforts at corporate rescue resulting in premature liquidations and leading to an unnecessarily risk adverse business environment to the detriment of shareholders and creditors. This possibility was described in *Sequana* by Lady Arden stating that a legislative rule could have "a chilling effect" and that often liquidations of companies can "be as damaging to creditors as to members".⁶³ In making these points, she referenced the work of the UK Company Law Review Steering Group (the UK Review Group) on whether the creditor duty should be codified as part of the UK 2006 Act. The initial view of the UK Review Group was against any codification of the creditor duty, as they believed it could interfere with the operation of the wrongful trading provision in s.214 of the Insolvency Act 1986.⁶⁴ However, in its final report, the UK Review Group changed its outlook, prioritising instead the importance of accessibility of the duties of directors:

it is important to draw to directors' attention that different factors may need to be taken into consideration where the company is insolvent or threatened by insolvency. To fail to do so would risk misleading directors by omitting an important part of the overall picture.⁶⁵

The UK Review Group ultimately proposed that directors should take a balanced view of the risks to creditors⁶⁶, such that where directors know or should know that the company is likely to be unable to pay its debts as they fall due, they should act to achieve a reasonable balance between reducing the risk to creditors and promoting the success of the company.⁶⁷ In response, the Government's White Paper concluded that the codification of directors' duties should

⁶² See, for example, cases such as *Hutton v West Cork Railway* (1883) 23 Ch D 654; *Percivil v Wright* [1902] 2 Ch. 421; *Re Smith and Fawcett Ltd* [1924] Ch 304.

⁶³ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [422].

⁶⁴ Modern Company Law for a Competitive Economy: Developing the Framework (2000), [3.73].

⁶⁵ Modern Company Law for a Competitive Economy: Final Report (2001), [3.12].

⁶⁶ *Ibid*, [3.17].

⁶⁷ *Ibid* at Annex C, para 8

exclude the creditor duty.⁶⁸ The argument in the White Paper was that if the duty to creditors was codified, directors would have to make finely balanced judgments and might err on the side of caution, undermining the rescue culture the Government was trying to promote.⁶⁹ Hence, the Government viewed codification as requiring too delicate a balance,⁷⁰ which could ultimately lead to the liquidations of companies that could have been rescued by trading out of financial difficulty.

The Irish Review Group, when considering the codification of directors' duties, also recommended the inclusion of a creditor duty. The principal basis for the Irish Review Group's recommendation to codify directors' duties was because the duties, as derived from case law, were inaccessible and incomprehensible serving as a disincentive for compliance.⁷¹ The Irish Review Group believed that these issues could be resolved by a statutory statement that was easier to access and understand.⁷² They recommended that a statutory statement of directors' duties should be accompanied by a duty to have regard to creditors when the company is insolvent.⁷³ What insolvency would mean, when the duty arose and what the duty prohibited in practice would be left to the courts - relying on the common law jurisprudence for guidance.⁷⁴ However, the duty was not included in the Irish 2014 Act. The Irish Review Group again recommended a duty to have regard to creditors in 2017, after giving the creditor duty more extensive consideration.⁷⁵ The group was careful to note the issues with codifying the creditor duty saying it was important not to:

create a situation whereby directors of companies which might recover would feel compelled (under pain of breach of duty) to bring an end to the company and wind it up. Striking the right balance can be very difficult when moving from a common law duty to a statutory duty. Viable companies can often be balance sheet insolvent when, for example, the value of their assets is on paper less than their borrowings and other liabilities. Imposing duties on the directors of such companies may go too far.⁷⁶

⁶⁸ "Modernising Company Law" Cm 5553-1, 2002. For a more detailed discussion see A. Keay, *Directors' Duties* (2nd edn, Jordan 2014) [13.4-13.11].

⁶⁹ White Paper, *Modernising Company Law* (Cm 5553-1) [3.11]; *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [433].

⁷⁰ In a second White Paper the Government acknowledged that the duty to promote the success of the company for the benefit of the members had certain limitations and was subject to enactments and rules of law to consider or act in the interests of creditors of the company. "Company Law Reform" Cm 6456, 2002

⁷¹ Company Law Review Group, First Report (2001), [11.3.1].

⁷² Which ultimately led to the enactment of s.228 of the Irish 2014 Act.

⁷³ Company Law Review Group, First Report (2001), [11.3.7].

⁷⁴ S. 227(5) of the Irish 2014 Act states that the duties of directors shall be interpreted and applied "in the same way as common law rules or equitable principles; regard shall be had to the corresponding common law rules and equitable principles in interpreting those duties and applying those provisions."

⁷⁵ Company Law Review Group, Report on the Protection of Employees and Unsecured Creditors (2017), [2.3].

⁷⁶ *Ibid*, 2.3.4. The exact wording recommendation was: "The directors of a company who believe, or who have reasonable cause to believe, that a company is unable or likely to be unable to pay its debts as they fall due, shall— (a) have regard to the interests of the company's creditors; and (b) preserve the company's property."

The Group's second recommendation came closest to enactment as part of a suite of 2020 Covid-19 measures⁷⁷, but the proposed duty was again not introduced into law.⁷⁸ Given the recommendations of the Irish Review Group, the complete omission of any mention of the creditor duty was difficult to understand, especially because of the emphasis placed on accessibility. As noted by the UK Review Group, the failure to mention the creditor duty could easily create an impression that there was no such duty existed.⁷⁹ The Irish omission was even more surprising given that the UK 2006 Act had seemingly reached a compromise between making it clear that a creditor duty existed without attempting to codify the specifics of the duty and the difficulty that would entail. S.172(3) of the 2006 Act states that the s.172(1) duty to promote the success of the company for the benefit of members operates 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".⁸⁰ It seems reasonably clear that s.172(3) is a statutory allusion to the common law duty, a recognition that a duty exists, survived the enactment of the UK 2006 Act but that its existence rests not on statute but on the judicially developed rules of law. That was the interpretation given to s.172(3) by the English Court of Appeal in *Bilta (UK) Ltd v Nazir*.⁸¹

However, despite s.172(3) seeming to merely recognise the existence of the common law duty, it became the subject of disagreement in *Sequana*. The disagreement was whether the section amounted to an express endorsement of the common law position to that point or amounted to a blank slate whereby the courts could reimagine the duty. In other words, were Parliament, in enacting s.172(3), explicitly endorsing the pre-2006 case law or merely enacting a neutral provision, neither approving nor disavowing the pre-2006 which would allow for greater judicial expansion. Lord Reed viewed s.172(3) as not explicitly endorsing the common law development prior to 2006. He stated that "[p]arliament was content to leave its further consideration and possible development to the courts"⁸² so long as the duty complements rather than contradicts the statutory prohibitions of wrongful trading.⁸³ Lady Arden similarly viewed s.172(3) as marrying the relevant legislation with the authority of the courts to develop this area further, without requiring "the courts to adopt or approve any rule of law in relation to

⁷⁷ Companies (Miscellaneous Provisions) (Covid-19) Act 2020.

⁷⁸ For a thorough analysis see P. Gavin, "Jumping the Gun: Codifying the Duty to Consider the Interests of Creditors in the Companies Act 2014" (2021) 65(65) *The Irish Jurist* 138.

⁷⁹ Some have questioned whether the creditor duty survived the enactment of the Irish 2014 Act see G. Brian Hutchinson, *Keane on Company Law* (5th edn, Bloomsbury 2016) 438. However, the heading of s.228 describes the section as a "Statement of principal fiduciary duties of directors" implying that other duties exist which are not stated in the section.

⁸⁰ S. 172(3) of the UK 2006 Act.

⁸¹ [2013] EWCA Civ 968. Patten J., speaking of s.170(3), stated that the 'obligation to act in the interests of creditors arises in circumstances where the company is or is likely to become insolvent and is no more than a statutory recognition of the decision of this court in *West Mercia Safetywear Ltd v Dodd*."

⁸² *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [71].

⁸³ *Ibid* [99].

creditors”.⁸⁴ Contrastingly, Lord Briggs believed that “even if the precise content of that rule of law may have had fuzzy edges, and might thereafter be subject to further judicial development,’ the historical context of enacting s.172(3) should be appreciated”.⁸⁵ On this view, s.172(3) did not merely approve the future development of the duty, but tacitly acquiesced to the rule *as* developed under *West Mercia*.⁸⁶ Lord Hodge went further stating that “[i]f this court were to overrule the *West Mercia* judgment it would be going against the recognition by Parliament of the existence of the common law duty to creditors”.⁸⁷

The disagreement as to the scope for judicial expansion after the enactment of s.172(3), a relatively straightforward provision with a reasonably clear purpose, is an illustrative example of the difficulty with codification of the creditor duty. It is a complex area, involves a difficult balancing of competing interests resulting in a reluctance in both the UK and Irish parliaments to codify the duty.

3. Recent Developments: *Sequana* and the Irish Regulations

Sequana: A Taciturn Ratio

As acknowledged by Lords Reed and Briggs, the *Sequana* judgment was the first significant consideration of the creditor duty by the UK’s highest court.⁸⁸ At its outset, Lord Reed acknowledged many of the questions posed by the duty:

[I]s it correct to say that there is such a duty? If it is, when does the duty arise: on insolvency (however that may be defined), or at some earlier point? What is the content of the duty? Is it a duty to treat the creditors’ interests as paramount, or are they merely to be treated as a relevant consideration, along with others?.....These are only a few of the questions which arise.⁸⁹

The *Sequana* judgment provides an extensive review of the creditor duty, and engages with many of the above questions, however, the primary question for the court concerned the circumstances in which the duty arose, specifically if it was triggered where there is a real risk of insolvency.⁹⁰ Such a test would expand well beyond technical insolvency, legislatively defined⁹¹ and even beyond the existing common law approach of close to or approaching insolvency as demonstrated by the facts of the case. The transaction in question was a shareholder distribution concluded at a time where the company “was unquestionably solvent”.⁹² However, the company faced a significant contingent liability based on an ongoing

⁸⁴ Ibid [344].

⁸⁵ Ibid [153].

⁸⁶ *West Mercia Safetywear Ltd v Dodd* [1988] B.C.L.C. 250.

⁸⁷ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [232].

⁸⁸ Ibid [8] per Lord Reed; [112], per Lord Briggs, with whom Lord Kitchin agreed.

⁸⁹ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [3].

⁹⁰ Ibid [9].

⁹¹ For example, s.123 of the UK Insolvency Act 1986.

⁹² *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [8].

environmental risk.⁹³ This contingent liability was recognised at the material time of the distribution, and was the very purpose behind the company's corporation as a vehicle for meeting these environmental claims.⁹⁴ However, the exact cost involved with this environmental liability was only an estimation and therefore imprecise. Once the liability fully manifested the cost lay clearly on the higher side of the estimations, with the company unable to meet these claims in full. Thus, the creditors sought to recoup the funds issued through the shareholder distribution partially on the basis that the directors should have considered their interests when concluding such a transaction given that there was a "real risk of insolvency". If the creditors were successful in their claim, it would mean that the expectation to consider creditor interests would clearly arise in circumstances notably earlier than the company's actual insolvency or approaching insolvency, instead becoming a duty pertinent to many boards facing real but contingent risks. It would also draw in to question many seemingly valid transactions, which fell far short of dissipating assets on the eve of liquidation.

The real risk of insolvency test was unanimously rejected by the Supreme Court.⁹⁵ Lord Reed stated that "the rule in *West Mercia* does not apply merely because the company is at real and not remote risk of insolvency at some point in the future".⁹⁶ The Court did point out that future liabilities are not to be ignored but and that directors should consider liabilities in the near future, but how far they should look into the future was a matter for the legislature.⁹⁷ While *Sequana* settles the question of real risk of insolvency, the judgment failed to identify a particular trigger point for the duty. The court acknowledged the wide range of expressions that had been used for requiring the consideration of creditors including "bordering on insolvency",⁹⁸ "on the verge of insolvency"⁹⁹ or 'potentially insolvent.'¹⁰⁰ The court's view was that these different expressions were "synonymous", conveying "a sense of imminence"¹⁰¹, Lord Reed stating that consideration should be given to creditors when the company is "bordering on insolvency or an insolvent liquidation".¹⁰² Importantly, the Supreme Court believed it was unnecessary to develop a precise trigger point for the duty.¹⁰³ Of course, a future case could prompt a more detailed examination of the trigger point of the duty, however, it now seems reasonably certain that the English courts are not engaged in judicial incrementalism,

⁹³ Ibid [350].

⁹⁴ Ibid [9].

⁹⁵ Ibid [10].

⁹⁶ Ibid [14].

⁹⁷ Ibid [308].

⁹⁸ *Bilta (UK) Ltd v Nazir (No 2)* [2015] UKSC 23 [123].

⁹⁹ *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 B.C.L.C. 153 [74].

¹⁰⁰ *In re Loquitur Ltd* [2003] EWHC 999 (Ch); [2003] 2 B.C.L.C. 422 [240].

¹⁰¹ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [88]. The court also noted that many of these expressions arise in obiter observations, since most of these cases concern companies which were actually insolvent at [179].

¹⁰² Ibid [94].

¹⁰³ Ibid [84]. It was noted that 'there is not to be found in them any clear guidance as to a precise answer to the "when" question.' [179].

moving over time toward a test but rather have a strong preference for leaving the duty openly defined, where a context first approach can be taken.

The question as to what the duty required from directors was deemed unnecessary to consider in detail.¹⁰⁴ Nevertheless, certain obiter statements shed a degree of light upon the duty itself. First, creditors are not owed a duty directly and so are not entitled to enforce the duty. Second, the creditor duty is not a separate, self-standing duty but is instead derived from a shift in the duty to promote the success of the company due to the company's financial difficulty.¹⁰⁵ Hence, even when the duty is triggered, creditors may not take priority over the interests of shareholders. It is only on liquidation itself where the interests of creditors become paramount. The Supreme Court took the view that neither shareholders or creditors enjoyed automatic priority once the duty arose and that the status of both creditors and shareholders should be recognised as having a residual interest. According to Lord Bridges, 'the creditor duty is a duty to consider creditors' interests, to give them appropriate weight, and to balance them against shareholders' interests where they may conflict.'¹⁰⁶ Hence, directors are expected merely to consider creditors interests in light of the company's circumstances and prospects and thereby decide the appropriate course of action. The duty is therefore a creature of context, both in asking whether the duty has been triggered but also in relation to what the duty entails.¹⁰⁷ Thus even where observers have welcomed the judgment for its efforts to ensure both clarity and flexibility, one cannot ignore the lurking uncertainties that remain at issue in the director's duty to consider creditors.¹⁰⁸

Ireland's Regulations

As of July 27 2022, Ireland's creditor duty is based in legislation.¹⁰⁹ Rather than being a product of a change in the outlook of the Irish Government, the Irish Regulations were introduced to give effect to EU law. Directive (EU) 2019/1023¹¹⁰ requires the enactment of a directors' duty to creditors where there where there is a likelihood of insolvency.¹¹¹ One undoubted benefit of the Regulations is that the creditor duty is now accessible through the Irish 2014 Act, which now provides a complete representation of directors' fiduciary responsibilities as originally

¹⁰⁴ Ibid [78].

¹⁰⁵ Described in *Sequana* as "*West Mercia* mode", [76].

¹⁰⁶ Ibid [176].

¹⁰⁷ Ibid [176].

¹⁰⁸ See P. Schilling de Carvalho and B. Reddy, 'Credit Where Credit's Due: The Supreme Court Take on Directors' Duties and Creditors' Interests' (2023) 82(1) *Cambridge Law Journal* 17, 20.

¹⁰⁹ S.224A of the Irish 2014 Act.

¹¹⁰ 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.

¹¹¹ Ibid, Chapter 5, Article 19. For an overview into the enacted duty in Ireland, see R. Breen, "An Appraisal of the Director's Duty to Creditors in Ireland" (2022) 29(10) *Commercial Law Practitioner* 191.

envisioned by the Irish Review Group.¹¹² Regulation 4 of the Irish Regulations inserts the following passage into s.224 of the Irish 2014 Act:

224(A)(1) 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.

The first important point to note is that S.224A adds an objective standard to the criteria necessary for the duty to apply. Under Irish common law, the duty arose only when the director was subjectively aware of the company's insolvency.¹¹³ However, the s.224(A) duty arises where the director has either subjective awareness or "reasonable cause to believe" that the company is, or likely to be, insolvent. Hence, the duty will apply to directors who hold unreasonable beliefs regarding the company's insolvency and who ignore objective evidence that the company is, or likely to be, insolvent. For example, if there is reasonable cause to believe a company is insolvent, such that a reasonable director would conclude as much, then a director's subjective conclusion that the company is in fact solvent will not shield a director from the duty's application. This evolution follows the trend of more objective assessment of directors' duties which prevents unreasonable subjective beliefs providing a basis for directors to avoid their responsibilities.¹¹⁴ This development also better reflects the practicalities of insolvency which is inherently multi-faceted. Doctrinal insolvency splits between balance sheet and cash flow standards. Identifying whether these standards are met is further complicated by the realities of insolvency involving a multitude of financial indicia and risk-weighted estimations.¹¹⁵ Centring the duty's trigger upon the director's reasonable cause to believe that company faces insolvency better addresses these realities as both the directorial and judicial guidance focuses on the grounds for which directors identify financial precarity. The reasonableness of the director's belief therefore becomes scrutinised in light of the business judgment and reasoning utilised by the board in assessing their financial state.

¹¹² Company Law Review Group, First Report (2001), [11.3.1].

¹¹³ See the discussion above of *Parkes v Hong Kong & Shanghai Bank Corp* [1990] I.L.R.M. 341 and *Re DSC Ltd; Fitzpatrick v Henley* [2006] IEHC 179.

¹¹⁴ For discussions of this trend in the context of the duty to act in the interests of the company and the duty of care see J. Quinn, "The Duty to Act in Good Faith in Light of the Business Judgment Principle" (2016) 27(4) *International Company and Commercial Law Review* 120 and B. Clarke, "Duty of Care Skill and Diligence – From Warm Baths to Hot Water" (2016) 56(56) *The Irish Jurist* 139 respectively.

¹¹⁵ P. Gavin, "A Rejection of Absolutist Duties as a Barrier to Creditor Protection: Facilitating Directorial Decisiveness Surrounding Insolvency through the Business Judgment Rule." (2021) 15 *Brooklyn Journal of Corporate Financial and Commercial Law* 313, 333-334.

The statutory duty imposes a mandatory obligation (“shall”) on directors to “have regard to” the factors listed in (a)-(c), (a) being the interests of creditors. Hence, there is no duty to act in the creditors’ interests and directors remain free to decline to take any action for the benefit of creditors. They simply must become aware of and consider the interests of creditors.¹¹⁶ That is not to say a director could not breach the duty, namely where they fail to have regard to creditors in their decision-making. Evidencing this failure is challenging as there is no guarantee that a director who considers the interests of creditors will behave any differently to a director who fails to consider these interests. A breach in duty is therefore more easily found where directors take a decision that is clearly detrimental to creditors such that no reasonable director could have taken the decision while having regard to creditors. For example, the dissipation of assets when it is clear the company will be wound-up, in accordance with *Re Frederick Inns*, will likely continue to be a breach of directors’ duties. This risk for breach is amplified by the wording of s.224A whose criteria – while only being factors to which directors must have regard – include the need “to take steps to avoid insolvency” and avoid grossly or intentionally threatening corporate viability.¹¹⁷ From expressing these considerations as necessities, one can infer that directors are not free to merely consider and dispense of these considerations. Instead, directors are expected to endeavour to balance these potentially conflicting criteria, all the while remaining considerate of the interests of the company and its creditors.

The most significant development in s.224(A) is the definition of insolvency as that set out in s.509(3) of the Irish 2014 Act. S.509(3) provides that a company is unable to pay its debts if:

- (a) it is unable to pay its debts as they fall due,
- (b) the value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities, or
- (c) the circumstances set out in section 570(a), (b) or (c) are applicable to the company.

The three s.570 grounds for deeming a company to be “unable to pay its debts” are as follows: (a) if a creditor is owed a sum exceeding €10,000 and serves a demand in writing requiring the company to pay the sum and the company fails to pay the sum inside 21 days to the reasonable satisfaction of the creditor (b) two or more creditors are owed a sum exceeding €20,000 and serve a demand in writing requiring the company to pay the sum and the company fails to pay the sum inside 21 days to the reasonable satisfaction of the creditors (c) if

¹¹⁶ Courtney states that a duty to “have regard to” can be “can be discharged by thinking about them: it does not demand they are acted upon. Having regard to a person’s interest means understanding what they would like by way of outcome from a corporate act or omission and, to the extent it is possible, harmonising that with the outcome that is in the company’s best interests.” See T. Courtney, *The Law of Companies* (4th edn. Bloomsbury 2016), [16.033]

¹¹⁷ S.224(A) of the Irish 2014 Act.

execution or other process issued on a judgment, decree or order of any court in favour of a creditor is returned unsatisfied in whole or in part.

Multiple technical definitions of insolvency can now be used as a basis for triggering the duty, the most notable of which is balance sheet insolvency under s.509(3)(b) where the value of the company assets is less than its liabilities. Because many companies temporarily fall into balance sheet insolvency, the duty is likely to apply to directors across a broad range of companies. Balance sheet insolvency was included without explanation from the Irish Government,¹¹⁸ and immediately drew criticism from Irish lawyers¹¹⁹ in part for going against Ireland's Company Law Review Group (The Irish Review Group) which specifically recommended avoiding balance sheet insolvency in any codification.¹²⁰

4. Examining Codification: Analysing the Common Law and Statutory Approaches

The question of whether the duty is best codified or left to the common law can be reduced to a preference for certainty. Keay has been strongly critical of the ambiguity of the common law on the basis that directors need to be guided by consistent and clear principles and should be able to tell with some degree of accuracy when the duty will arise.¹²¹ Keay is correct that the fact first approach of the English courts makes it impossible for a director to anticipate what conclusion a court might draw from the facts in an *ex post* determination several years in the future. This uncertainty is also noteworthy for parties on the other side of litigation. Liquidators, unsure of the likelihood of a claim's success and the certainty that a director has indeed breached their duty to the company, will inevitably be more hesitant in their decision to launch claims against the directors. This hesitancy is exacerbated by the fact that any such claims are mounted on the back of the insolvent company's already depleted assets, meaning that uncertain prospects of success in litigation may further discourage the liquidator from utilising these funds in pursuit of directorial liability. It does seem reasonable for business people, both directors and liquidators, to expect some degree of clarity regarding these legal obligations to the company and *Sequana* has only strengthened Keay's argument by providing no additional practical guidance for directors. If a highly detailed consideration by the UK Supreme Court has done little, if anything, to clarify matters, it seems unlikely an English court will do so in the near future.

¹¹⁸ Although Irish Regulations were accompanied with an information note, it did not provide any detail into the how the legislative framework for the duty was crafted, outlining instead in general terms how the function of the duty within the broader framework of preventative restructuring. See, Department of Enterprise, Trade and Employment *European Union (Preventive Restructuring) Regulations 2022 Information Note* (2022).

¹¹⁹ T. Courtney, S. Kearney and D. O'Leary, Directors' Duties: New Statutory Duties to Have Regard to the Interests of Creditors available at <https://www.arthurcox.com/knowledge/directors-duties-new-statutory-duties-to-have-regard-to-the-interests-of-creditors/>.

¹²⁰ Company Law Review Group, Report on the Protection of Employees and Unsecured Creditors (2017), [2.3.4].

¹²¹ See A. Keay, "The Director's Duty to take into Account the Interests of Company Creditors: When is it Triggered?" (2001) 25 *Melbourne University Law Review* 315, 316.

Codification has the potential to introduce a degree of certainty by providing increased clarity for when the duty arises and by setting some guidelines for what the duty requires from directors, or at least what actions are prohibited. A codified duty could also clarify the relationship between the creditor duty and existing legislative provisions such as wrongful trading, s.172(1) and the legislative meaning of insolvency. The Irish Regulations can provide a starting point to re-examine the value of codification by offering an example of a codification which has added an increased degree of certainty compared to the common law position. The Regulations have introduced an objective standard and have set out legislatively defined criteria for when the duty arises. However, the inherently complex, context dependent nature of the creditor duty means that arguments for codification should proceed with caution. It is important to remain cognisant of concerns highlighted in *Sequana*¹²² and by both Review Groups that a codified duty could inhibit reasonable attempts to trade out of difficulty and lead to premature liquidations.

Scope of the Duty

Many of the obiter observations in *Sequana* dealt with the appropriate content of the duty. The court broadly endorsed what is effectively a two-stage duty wherein creditors are to be considered when the duty being triggered and become the paramount consideration where insolvency is irreversible.¹²³ Prior to irreversible insolvency, a company retains a viable prospect for a return to solvency and creditor and shareholder interests are to be balanced by directors.¹²⁴ This provides little practical guidance for directors but is perhaps understandable given it was not the issue under appeal and also because duty's scope cannot be strictly defined given the importance of the specific business context in balancing the interest of creditors and shareholders. However, the Irish Regulations do introduce a modicum of certainty, providing some guidelines for directors. The Irish duty provides that directors must consider the interests of creditors alongside their existing duties to consider the interests of shareholders and employees¹²⁵ and act in good faith in the overarching interests of the company.¹²⁶ While this presents a similar picture to *Sequana*, the Irish duty provides further guidance by having directors consider “the need to avoid deliberate or grossly negligent conduct that threatens the viability of the business of the company”.¹²⁷ This guides directors not only in emphasising the corporate viability as a litmus test for appropriate corporate strategy but in premising breaches of duty on “deliberate or grossly negligent conduct”.¹²⁸ This is clearly a high threshold of culpability, providing scope for policies designed toward corporate rescue and limiting the

¹²² *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [422].

¹²³ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [50].

¹²⁴ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [164].

¹²⁵ See, Companies Act 2014, s.224.

¹²⁶ See, Companies Act 2014, s.228(1)(a).

¹²⁷ Companies Act 2014, s.224A(1)(c).

¹²⁸ *Ibid.*

potential for the legislation to chill board decisiveness when navigating turbulent financial difficulty.

A criticism of the creditor duty raised by Keay is that imposing a duty to consider creditor interests is worrisome simply because directors are unfamiliar with what creditor interests entail as their corporate existence to date has been governed by entrepreneurship, corporate success and shareholder interests.¹²⁹ This implies a risk that directors who suddenly decide to act in the creditors' interests may see such an obligation as an impetus for liquidation rather than an opportunity to navigate financial distress. The Irish duty does not necessarily resolve this risk as appropriate service to creditor interests or the balancing between competing investor interests remain elusive concepts. Nevertheless, this risk is somewhat mitigated by the standard of deliberate and grossly negligent conduct both because this confirms a deferential approach to directorial decision-making and because gross negligence as a concept for corporate compliance is not unique to the creditor duty and might therefore already be familiar to directors as they grapple with the unfamiliar concept of creditor interests while navigating the uncertainties of insolvency. When considering codification in the UK, a similar, bright line standard of breach may help dissuade the view that a codified duty will necessarily lead to premature liquidations and a more risk averse business environment.

Knowledge as a Trigger

One clear difference between the common law and Irish codification is in regard to whether a director must be subjectively aware of the company's insolvency or financial difficulty in order for the duty will apply. The Irish duty applies to a director who has reasonable cause to believe that the company is, or is likely to be, unable to pay its debts. Hence, there is now a clear objective basis to enforce the duty which should make it easier for liquidators taking claims as there is no need to establish the directors' subjective knowledge of the company's insolvency. Contrastingly, the judges in *Sequana* disagreed on whether the subjective knowledge of the company's insolvency or financial difficulty was a necessary element for the duty's application. Lord Briggs¹³⁰ and Lord Hodge¹³¹ believed the duty would only be triggered by the director becoming aware of the looming insolvency or probability of liquidation, in part because such an interpretation aligns with statutory prohibitions against wrongful trading.¹³² Lord Reed was comparatively "less certain" that knowledge forms a necessary ingredient for the duty,¹³³ as no such requirement is suggested under *West Mercia* and the duty is distinct

¹²⁹ See, A. Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) 64 *Cambridge Law Journal* 614, 626.

¹³⁰ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [203].

¹³¹ *Ibid* [231], [238].

¹³² See, 2. 214 of the Insolvency Act 1986. For analysis see A. Keay, "Wrongful Trading: Problems and Proposals" (2014) *Northern Ireland Law Quarterly* 63; R. Williams, What Can We Expect to Gain from Reforming the Insolvent Trading Remedy? (2015) 78 *Modern Law Review* 55.

¹³³ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, [90].

from wrongful trading.¹³⁴ While acknowledging that due care requires directors be abreast of the company's financial condition,¹³⁵ Lady Arden adopted a similar stance to Lord Reed which leaves "the question of knowledge open for full submissions"¹³⁶ as "it is unnecessary and inappropriate to express a concluded view without the benefit of argument".¹³⁷ Hence, after *Sequana*, the question of the requisite knowledge remains unresolved. While, in stark contrast, the Irish legal position is clearly set out – subjective unawareness of the company's financial position is not a basis for a director to escape the duty's application. This highlights that a degree of certainty can be introduced through codification.

The Irish "reasonable cause to believe" criterion echoes the original UK Review group proposal for codification where a director knowing or would know the company was likely insolvent "but for a failure of his to exercise due care and skill."¹³⁸ While the duty to act with due care was historically associated with a subjective standard, it has increasingly been judged against the 'general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions' of a director. Linking the director's appreciation of the company's financial position to a standard of due care keeps the expectations upon directors in line with this reasonableness standard. Importantly, both the Irish regulations and the UK Review group's proposal remain cognisant of the director's belief, avoiding the harshness of a truly objective standard which may struggle to account for hindsight bias and further underpinning the policy preference towards corporate rescue.¹³⁹ While courts are loath to scrutinise the substance of directorial business judgment, scrutinising the process and informed nature of that judgment is more judicially palatable.¹⁴⁰ Hence, as stated above, while codification can clarify the question of the need for directors' subjective awareness, it remains important to place the legislative emphasis on the reasonableness of the director's beliefs regarding the company's financial position.

Concerns over Codification

The strongest argument against setting out criteria *ex ante* for both triggering the duty and what it requires from directors is that it could 1) it could cause directors to become risk averse encouraging passive asset preservation and discouraging reasonable attempts at corporate rescue and 2) lead to cases where appropriate weight could not be given to the context because

¹³⁴ Ibid [94](ii).

¹³⁵ Ibid [304].

¹³⁶ Ibid [281], per Lady Arden.

¹³⁷ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, [90].

¹³⁸ Company Law Review Steering Group, *Modern Company Law For a Competitive Economy: Final Report* (London 2001) 347. For a discussion on this provision see, *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [430]-[434], per Lady Arden.

¹³⁹ See A. Keay, *Company Directors' Responsibilities to Creditors* (Routledge 2007), 250. For an overview into the policy of business rescue and the financial support of distress debt such as through the informal London Approach, see V. Finch, 'Corporate Rescue in a World of Debt' (2008) 8 *Journal of Business Law* 756.

¹⁴⁰ See A. Keay, J. Loughrey, T. McNulty, F. Okanigbuan and A. Stewart, 'Business Judgment and Director Accountability: A Study of Case-Law Over Time' (2020) 20(2) *Journal of Corporate Law Studies* 359.

of the language used in codifying the duty. Both arguments come to the same point, that courts or directors will base their decisions on technical definitions rather than by reference to the business context, leading to a form of mechanical jurisprudence¹⁴¹ or business management. Sealy has strongly argued against the law of fiduciary obligations shifting based on “technicalities”, stating in the context of fiduciary duties to creditors that “neither the actual fact of insolvency nor the definition by which it is determined should be a decisive factor”.¹⁴² His view is that directors' decisions should be taken by “reference to the company as an ongoing business concern and should be judged by that broad standard, not by technicalities”.¹⁴³ An illustrative case is the Irish High Court case of *Re Hefferon Kearns Ltd*¹⁴⁴ where reckless trading proceedings were initiated against the directors of an insolvent company.¹⁴⁵ The facts were such that it was better for the company’s creditors to avoid an immediate liquidation, continue trading and incur even more debt, in order to complete an unfinished contract. Lynch J. provided a clear endorsement of the fact that sometimes it is necessary to continue trading, and even incur more debt, despite the company’s serious financial difficulty:

it would not be in the interests of the community that whenever there might appear to be any significant danger that a company was going to become insolvent, the directors should immediately cease trading and close down the business. Many businesses which might well have survived by continuing to trade....could be lost to the community.¹⁴⁶

In *Secretary of State for Trade and Industry v Gash*¹⁴⁷ Chadwick J. arrived at a similar conclusion stating that directors:

may properly well take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss making trade should be accepted in anticipation of future profitability.¹⁴⁸

On their face, these examples of incurring additional debt while insolvent, and loss-making trade, would be presumed to be harmful to creditors. Yet, in the broader business context, both

¹⁴¹ To borrow the language of Pound, who argued against the rigid application of concepts and principles to contract law. R. Pound, “Mechanical Jurisprudence” (1908) 8 *Columbia Law Review* 605.

¹⁴² L. Sealy, “Directors Wider Responsibilities – Problems Conceptual, Practical and Procedural (1987) 13 *Monash University Law Review* 164, 179.

¹⁴³ *Ibid.*

¹⁴⁴ [1993] 3 I.R. 191.

¹⁴⁵ It was taken under s.297A of the Companies Act 1963, the same provision is now in s.610 of the Irish 2014 Act.

¹⁴⁶ *Re Hefferon Kearns Ltd (No. 2)* [1993] 3 I.R. 191, 224. Other Irish cases have expressed similar ideas recognising that trading while insolvent or close to insolvency may be the correct commercial decision once the “creditors’ interest are kept to the fore” (*Re USIT World Plc* [2005] IEHC 285, [70-71]) and it doesn’t include “careless or reckless” gambling (*Re Filte Logistics and Distribution Ltd* [2016] IEHC 589, [45]).

¹⁴⁷ [1997] 1 B.C.L.C. 341, 348.

¹⁴⁸ *Ibid.*

were found to be for the benefit of creditors. The cases highlight the danger of rigid formulations in the complex context of corporate insolvency and rescue and the ambiguity of the common law facilitates a reasoned analysis of the overall context. The purpose of the creditor duty is to adjust for the point in a business when the creditors are the primary risk bearers of director decision making; that is what justifies fiduciary protection above and beyond contract. The only possible way to determine the extent to which creditors are bearing such risk is by reference to the facts and the company in question and so any codified duty must allow scope for courts to attach the appropriate weight to the specific facts in the case.

The triggering point for the Irish duty is based on technical definitions of insolvency, including balance sheet insolvency, a point which has received criticism from Irish lawyers. It is the most likely aspect of the codification that could lead to directors altering their decision making on technical definitions, rather than a wholistic view of the overall business. Balance sheet accounts fluctuate regularly in many businesses, many companies frequently fall into, or are likely to fall into, insolvency according to their balance sheets. This means the codified duty has greatly expanded in scope and the duty will apply to directors across a wide range of companies. This could cause directors to become more risk averse, prioritising creditors once the company enters, or is likely to enter balance sheet insolvency. However, there is little basis in the Irish codification for directors to become significantly more risk averse or less likely to attempt corporate rescue. Sealy's argument regarding "technicalities" rests on the assumption of a prescriptive duty, strictly defined. The Irish Regulations introduce no such prescriptive duty and while technical definitions of insolvency are used broadening the duties scope of application, the duty merely requires directors to "to have regard" to creditors. The legislative rules place no positive obligation on directors to act in favour of creditors and certainly do not require the cessation of trade or liquidation merely because the company has entered, or is likely to enter, balance sheet insolvency. If directors have reasonable grounds to believe it to be the interests of creditors to continue trading, despite the company's clear insolvency, they will not breach the legislative duty. So, while the Irish codification has adopted technical definition of insolvency, great scope remains for both directors and courts to decide what having regard to actually means in any given context.

Ultimately, Ireland's codified duty still facilitates an approach where the facts play a crucial role in how the duty operates. While this inevitably results in a degree of uncertainty, some uncertainty in this area of law is inevitable. In the words of Lord Briggs in *Sequana*, the meaning of creditors duty's and what it requires from directors depends on, and should continue to depend on, the context:

Much will depend upon the brightness or otherwise of the light at the end of the tunnel; i.e. upon what the directors reasonably regard as the degree of likelihood that a proposed course of action will lead the company away from threatened insolvency, or back out of actual insolvency. It may well depend upon a realistic appreciation of who, as between

creditors and shareholders, then have the most skin in the game: i.e. who risks the greatest damage if the proposed course of action does not succeed.¹⁴⁹

However, and in contrast to *Sequana*, the Irish codification has managed to introduce a greater degree of clarity while maintaining an approach where the broader context and deference to business judgment remains central, a balance that could also be achieved in the UK. The UK would need to achieve this balance with some formalistic differences to Ireland, namely in accounting for duty's interaction with s.172. Nevertheless, the legislative interventions in the Irish regime which firmly clarify the duty's trigger and the role of knowledge held by directors can be substantively mirrored in the UK framework and thereby address lingering uncertainties in the UK without stymying the exercise of business judgment by directors.

This is not to suggest that if the UK was to codify its duty, it should simply transpose the Irish provision. Instead, any UK codification should account both for the broader differences between the Irish 2014 Act and UK 2006 Act. The Irish duty is positioned alongside the duty to consider employee and member interests,¹⁵⁰ separate from but complementary to the director's general duty to act in good faith in the company's interests.¹⁵¹ Whereas the UK introduced the notably expansive s.172(1),¹⁵² Ireland simply enacted a succinct affirmation of the common law duty, stating that the directors shall 'act in good faith in what the director considers to be in the interests of the company.'¹⁵³ At all times, the director of an Irish company owes service to the company's interests. The advent of insolvency merely forces directors to consider inter alia the interests of creditor under s.224A as they discharge their duty to act in the company's interests. Importantly then, it is not necessary to suspend the duty towards the company's interests as the very concept of these interests is relatively abstract so as to facilitate the content of the duty shifting towards creditors in the context of insolvency. The UK s.172(1) duty is comparatively more complex, since its obligation is more specifically 'to promote the success of the company *for the benefit of its members as a whole*.'¹⁵⁴ A duty to consider creditors may come up against the general duty under s.172(1) and its explicit focus on members, creating a conflict not exhibited by the Irish 2014 Act. It may therefore be necessary to disapply the operation of s.172(1) in order for a duty to consider creditors to have the desired effect. The need for such disapplication is indeed evidenced in the most notable effort towards a codified duty in the UK. Within the UK Review Group's proposal for a codified duty the general s.172(1) duty was to be disapplied in favour of a duty to achieve what the director believes to be 'a reasonable balance between (i) reducing the risk ... [of insolvency]; and

¹⁴⁹ *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [176].

¹⁵⁰ S.224 of the Irish 2014 Act.

¹⁵¹ P. Gavin, "Jumping the Gun: Codifying the Duty to Consider the Interests of Creditors in the Companies Act 2014" (2021) 65(65) *The Irish Jurist* 138, 145-146.

¹⁵² S.172(1) of the UK 2006 Act.

¹⁵³ S.228(1)(a) of the Irish 2014 Act.

¹⁵⁴ S.172(1) of the UK 2006 Act (emphasis added).

promoting the success of the company for the benefit of its members.’¹⁵⁵ The broader context of the UK 2006 act is therefore key as the efficacy of any codified duty in the UK turns not just on how the duty itself is enacted but also on how the other duties, namely s.172(1), are potentially disapplied to facilitate the consideration of creditors.

CONCLUSION

The developments in 2022 mark an important development in our understanding of the creditor duty. Whereas common law commentators awaited the *Sequana* judgment for its insights into the future of the creditor duty, jurisdictions within the European Union faced an obligation to transpose a statutory duty. Straddling these two legal spheres, Ireland finds itself both vested in the persuasive dicta of *Sequana* and a legislatively defined creditor duty. While the *Sequana* judgment is useful as a tool for understanding the development of the creditor duty to date, it can hardly be seen as moving the needle on any remaining issues other than in confirming what the duty is not i.e.: that it is not applicable due to a real risk of insolvency. Given the arguably inert nature of these judicial developments, the time may be ripe for the UK to reevaluate the question of codification. While critics may still legitimately present concerns over the potential rigidity of a legislative duty, arguing that the duty is better left to judicial development is certainly less convincing when development appears as inactive as it was in *Sequana*. Turning to Ireland as a comparative benchmark of such codification would be logical and serves to dispel some of the concerns over a codified duty.

The Irish codification has introduced a degree of clarity over and above the common law position, particularly in relation to the trigger point of the duty and by removing the requirement for subjective knowledge of the company’s insolvency. Yet there remains scope for the broader business context to be considered and, once directors avoid deliberate or grossly negligent conduct, the legislation preserves scope for attempts at corporate rescue. Given that post *Sequana*, English common law is unlikely to see significant foreseeable development, a statutory duty may be appropriate. Such a duty need not be dissimilar from that now evidenced with the Irish 2014 Act, so long as suitable adjustments are made to the statutory text to ensure that the duty’s elements conflict neither with each other nor with the broader obligations imposed upon directors within the UK 2006 Act.

¹⁵⁵ Company Law Review Steering Group, *Modern Company Law For a Competitive Economy: Final Report* (London 2001) 347; *BTI 2014 LLC v Sequana SA* [2022] UKSC 25 [430].