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IN WHOSE INTERESTS SHOULD COMPANIES BE RUN?

This is one of the most contested questions in modern company law. In the UK it is usually answered by saying that companies must be run for the benefit of shareholders, but the recent decision of the UK Supreme Court – in *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 – provides a new lens on the question. This article explores these issues in the context of a company being financially distressed and thus potentially trading not at the expense of shareholders but creditors. It explains the law and shows that creditors provide a rare example of a case where in the end shareholders' interests may be displaced by those of another group, concluding with a short discussion of some possible implications for duties to other stakeholders.

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I. The Virgin Orbit case as context

1 A British entrepreneur, Richard Branson, decided to set up a business to launch commercial satellites into space from a rocket through a company called Virgin Orbit, which was formed by another group company, Virgin Galactic, which had issued publicly traded securities and raised many millions of dollars. In January 2023, Virgin Orbit, which had made some successful launches elsewhere, sought to launch a rocket from a jumbo jet from the UK – however, the rocket failed to orbit and the satellites were lost. There was a loss of confidence in Virgin Orbit's business and Branson was unable to raise enough money to operate or expand it. Employees were furloughed and the company had to file for relief from its creditors under Chapter 11 of the US Bankruptcy Code.[2]

1 The author was a Justice of the High Court of England and Wales from 1993 to 2000, a member of the Court of Appeal of England and Wales from 2000 to 2018 and a Justice of the UK Supreme Court from 2018 to 2022. This article is based on a lecture given in Singapore in April 2023 as Jones Day Visiting Professor at the National University of Singapore.

2 The UK now has a system for creditors' schemes which is broadly similar. It has had for some time a system of administration of companies to allow them to trade out of their difficulties and find solutions to their debt problems. Administration requires the appointment of an independent administrator.

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2 This sequence of events sounds unusual because there are very few companies engaged in activities in space, but the factual pattern is not uncommon. Talented directors think of new ideas to set up businesses which benefit us all, not just themselves. But things can happen which make a company fail. There will be a period when they are not sure whether the company will fail or not. They may think it is solvent one week because there is a good chance of further finance, but another week they may realise it is insolvent.

3 What are directors' responsibilities in relation to creditors? The up-to-date position is to be found in the recent decision of the UK Supreme Court in *BTI 2014 LLC v Sequana SA*[3] ("*Sequana*"), which lies at the heart of this article. Before *Sequana* is discussed, however, this article will try to put the question (in whose interests should companies be run?) into its historical perspective by briefly tracing the development of corporate responsibility to parties who are affected by a company's activities in some capacity other than that of a shareholder, particularly creditors. These are the people whom we would call stakeholders today. The company's responsibilities to them are not spelt out by statute but have evolved in response to changing commercial practice and expectations as to how companies should behave.

II. Historical development of corporate stakeholder responsibility

4 The development of corporate stakeholder responsibility can conveniently be divided into three eras. First, there is the historical era. In this era, the objective of forming companies was pure wealth creation for shareholders. Losses may have arisen but there was no special duty owed to creditors.

5 The second era was the "best interests" era. In this era, the primary objective of a company remained profit creation for shareholders, but a wider view was taken of the ways in which these interests could be achieved.

6 The third era is the current era, which may be called the stakeholder era. In this era, it is not simply discretionary but routine for directors to consider how the exercise by them of their powers may not only benefit shareholders but also stakeholders.

7 This article will discuss each of these eras further.

3 [2022] 3 WLR 709.

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A. The historical era

8 This era started with the South Sea Bubble and its aftermath. In 1711, the British Parliament passed an Act known as the South Sea Act preventing the incorporation of new joint stock companies. Existing companies, including the South Sea Company, were excluded from this prohibition. Money was freely invested in the South Sea Company's securities because the British Parliament granted to it some of the trading privileges and monopolies which Britain received following the passage of the Treaty of Utrecht.[4]

9 There was enormous speculation in the South Sea Company's shares. They rose in value from £100 to £1,000. The expected profits from the south seas, which were expected to sustain the project, did not materialise. The bubble burst and large numbers of investors were ruined. Sir Isaac Newton was asked about the matter and he is attributed with saying: "I can calculate the movement of the stars, but not the madness of men."[5]

10 The South Sea Bubble was nothing short of a national disgrace,[6] but it led the UK Legislature to provide a means of forming companies by a new system of registration. These companies were "limited" companies. Significantly, Parliament required limited companies to include the word "limited" in their name to warn prospective creditors of that fact. That signifies that historically there was a concern that creditors should know that they were dealing with a company with limited liability and that they should realise that they are taking a risk. One might for instance pause to ask oneself why it is that American companies are called "XYZ Inc" and British companies are called "ABC Limited." The use of the word "limited" in a company's name is a signal to creditors that they may not be paid in full. By implication, creditors are expected in the main to look after themselves. We shall see that theme again in the third era.

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4 The government of the day also used the South Sea Company as a means of getting rid of the national debt. This was achieved by the British Parliament passing legislation requiring holders of national debt to transfer their holding to the South Sea Company in exchange for shares. The British Government then paid a small sum of interest to the South Sea Company. The former holders received a marketable security in exchange. In the end, the South Sea Company was the largest holder of the national debt.

5 Jonah Lehrer, *Proust was a Neuroscientist* (Canongate, 2012) at p 27.

6 It was the subject of parody in literature, including Charles Dickens' *Nicholas Nickleby*. Nicholas Nickleby had an uncle who had a joint stock company called "United Metropolitan Improved Hot Muffin and Crumpet Baking and Punctual Delivery Company".

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11 So far as the directors of a company are concerned, even in this formative period, the law imposed fiduciary duties on directors, and not just common law duties. Fiduciary duties are duties derived from trust law. They apply to persons who deal with property belonging to others. Directors are stewards of the property of the company for the shareholders. The core difference between fiduciary and common law duties is that the fiduciary owes an obligation of undivided loyalty.[7] Furthermore, the liability to account in equity for breach of fiduciary duty is much stricter than for breach of a common law duty. The wrongdoer may be liable to account to a beneficiary for a profit he has made even if the beneficiary could not have made the profit himself.[8] Moreover, if there is a breach of duty the onus shifts to the wrongdoer to show that he did not make a profit.[9] That does not happen at common law.

12 In the middle of the 19th century, the British Parliament also legislated for the winding up of companies and it vested winding up jurisdiction in the Courts of Chancery. Improvements were made to the procedure for winding up. The winding up legislation is a recognition that a system of registered companies could not be allowed to operate or would not flourish without an efficient system for the winding up of companies and a fair system for the distribution of their assets to those entitled.

13 Following the Companies Act 1862,[10] the House of Lords in *Salomon v A Salomon & Co Ltd*[11] famously held that a registered company had a separate personality and that a member was not liable for the debts of his company. The approach in this case plays a part in *Sequana* too. Mr Salomon, one of the founders of the company, sold his business to his company at an overvalue in exchange for secured debentures. In the words of Lord Macnaghten, the unsecured creditors had only themselves to blame. They could have bargained for security too. As Lord Reed put it in *Sequana*,[12] the creditors' protection lay in their own hands. That same philosophy continues today in the practice of bankers and others when they ask a debtor company to provide them with additional protection to reduce the risk of loss in the event of insolvency. There were, moreover, important economic consequences flowing from the recognition of the company as a separate legal entity. Once the limited company was regarded as a separate legal entity and became one of the most common

7 See *Bristol and West Building Society v Mothew* [1998] Ch 1, *per* Millett LJ.
8 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 46.
9 *Murad v Al-Saraj* [2005] EWCA Civ 959.
10 c 89 (UK).
11 [1897] AC 22.
12 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [27].

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methods of carrying on business, there was room for the development of an economy based on trade rather than the ownership of land.

14 The British Parliament did not, and clearly felt no need to set out the purpose of companies in the Companies Act 1862. This has remained the case ever since. It is perhaps also the same in the Singapore Companies Act 1967.[13]

15 Nor did the UK Parliament, until very recently, see the need for the companies legislation to set out the general duties of directors. The fiduciary duties developed by the Courts of Chancery applied. Chief among them was the duty to act in what the directors considered to be in the best interests of the company. The fiduciary duties were also dynamic. They could be developed by application of the underlying principles in new situations. This is illustrated by *Item (Software) UK Ltd v Fassihi*.[14] In this case, a director made a profit without disclosing his own wrongdoing. It was for the first time held that the failure to disclose was of itself a breach of the duty to act in the company's best interests.

16 Everything in the companies legislation confirmed that the shareholders were in pole position. There was (and is) no statutory means for creditors to sue the directors or to requisition meetings or to appoint directors (they could only do so if they had some special contractual right to do so) or to receive the financial statements and so on.

17 This historical era ended at the end of the 19th century.

B. The "best interests" era

18 At the start of the 20th century in the UK, the tide started to turn against the idea that companies had to be narrowly focused on wealth creation for the benefit of shareholders. Some directors at least had become more enlightened. This article cannot say precisely when or why this was, but it had certainly turned by the time that *Evans v Brunner, Mond & Co Ltd*[15] ("*Evans v Brunner Mond*") was decided in 1921. In this case, the court took an expansive approach to what might fall within the best interests of the company.

19 In *Evans v Brunner Mond*, there was a challenge by a shareholder in a chemical company to a proposal by directors to donate a substantial sum to fund a scholarship for study in any field of science. A shareholder

13 2020 Rev Ed.
14 [2005] ICR 450.
15 [1921] 1 Ch 359.

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contended that the payment of this sum was *ultra vires*. Eve J rejected that challenge. The question was whether the payment was *ultra vires* the company's memorandum of association. The company relied on an express power to make distributions to universities for the purpose of the furtherance of scientific education or research. There was no necessary link between the company's business and the field of scientific education proposed to be funded. The research might indeed directly benefit a competitor's business.

20 However, Eve J held that this was a matter for the proper exercise by the directors of their discretion. There was uncontradicted evidence from the directors of the company that they desired to encourage a class of persons who would cultivate the scientific attitude of mind and be prepared to devote their abilities to scientific education and research. These people would then form a reservoir of trained experts from which the company could select its employees. Eve J was satisfied that there did not have to be a link between the proposed field of study and the company's business if the directors were satisfied that it was in the best interests of their company to build up a fund of this nature. Although the challenge was based on *ultra vires*, it is clear that Eve J considered that the directors could, if they thought fit, effectively determine that the transaction was in the best interests of the company. He went further and concluded that "the advantages to accrue to the company are direct and substantial and not too speculative or too remote" and further that "the proposed expenditure will not only be to the direct advantage of the company, but is also conducive to, and indeed necessary for, its continued progress as chemical manufacturers".[16]

21 On this basis, directors can consider the interests of third parties, in this case universities and students, provided that their decisions have derivative benefits for shareholders. It is therefore the concept of the "best interests of the company" that determines the question of whether the company can benefit stakeholder interests as well as those of members.

22 An example may demonstrate the practical importance of the "best interests" concept. Suppose a bank decides to make low-cost loans to an inner-city project. These loans do not meet its normal risk standards, but the directors consider that it is in the interests of the banking industry to maintain the vitality of poor urban areas and that some relaxation of lending standards is essential for this purpose. The plan will mean a reduction in profits because of the increased risk of loss but the directors, having exercised due care, conclude that lending to the project is in the bank's long-term interests. That decision will comply

16 *Evans v Brunner, Mond & Co Ltd* [1921] 1 Ch 359 at 368–369.

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with the best interests rule even though it causes loss to shareholders. That is the implication of *Evans v Brunner Mond*.

23 However, we must note that the "best interests principle" only applies if the directors decide to invoke it. For employees, that may not be enough. Employees are a special group because they do not always have the ability of shareholders to realise their investment in a company at a moment's notice and to redeploy their capital elsewhere.

24 Sometimes, a company seeks to alleviate the hardship suffered by its employees when it ceases to trade by providing gratuitous benefits for them. However, in *Parke v Daily News Ltd*[17] it was held that this was *ultra vires*. As the saying goes, in company law, there can be "no cakes and ale" except if they are for the benefit of the company.[18] Lord Reed reiterated that principle in *Sequana*.[19]

25 In the UK, Parliament stepped in in 1980 to make it obligatory for directors to consider the interests of employees. The legislation became s 309 of the Companies Act 1985,[20] which stated as follows:

> **309 Directors to have regard to interests of employees**
>
> (1) The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.
>
> (2) Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.

Subsection (1) gives the impression that members and employees are to be treated as on a par. However, that impression is contradicted by subsection (2), which renders the provision unenforceable by the employees themselves and makes it clear that the section does not enlarge the meaning of the interests of the company so as to include the interests of persons who are not members. That meant that the interests of employees could never displace the interests of members. Shareholders could moreover still ratify or authorise a breach of the duty in s 309(1). In the event, s 309(1) had little practical effect.

17 [1962] Ch 927.
18 For this principle, see the judgment of Bowen LJ in *Hutton v West Cork Railway Co* (1883) 23 Ch D 654.
19 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [66].
20 c 6 (UK).

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III. The stakeholder era

26 This is the era in which the objective is not simply to benefit shareholders or the company but also to confer some benefit on some stakeholders in the company in their own right. Where this is done by framing the directors' duty in a new way, the legislation may be said to create a "stakeholder model". Different legislatures have devised different stakeholder models – there might for instance be simply a duty or a discretion to consider stakeholders' interests, or there could be a duty to act in their interests, treating stakeholders on a par with shareholders. As the decision of the UK Supreme Court shows, the UK's Companies Act 2006[21] does not go that far. The position taken by the UK followed a thorough investigation into law and practice and public consultation, as this article will now explain.

27 In the Companies Act 2006, the UK's version of the stakeholder model was achieved through a new statutory statement of the duties of directors. A statutory statement of directors' duties was a remarkable achievement because a powerful legal profession had argued for over a century that fiduciary duties would lose their essential flexibility if they were set out in statute. How that particular change happened is, however, outside the scope of this article.

28 In the UK there has been a reasonably regular cycle of consolidating the companies legislation every 20 to 40 years. Parliamentary practice enables this to be preceded by an amending Act, altering those matters which need to be changed to enable an up-to-date version of the legislation to be consolidated. This process provides an opportunity to reflect on all the provisions of the legislation. Before being appointed a judge in 1993, this author had been involved with company law reform since about 1977 and in that period, there had been a continuous series of Bills to amend aspects of company law. Many, but not all, of these Bills were promoted by the government of the day. In the period following World War II, there were consolidation Acts passed in 1948 and 1985, re-enacting prior legislation subject to any pre-consolidation amending Act. In recent times they served the further purpose of bringing together what by then had become fragmented legislation. By the end of the 1990s, however, the legislation was again in need of a major overhaul.

21 c 46 (UK).

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A. *The work of the Law Commissions*

29 In 1996, this author was appointed Chair of the Law Commission of England and Wales (the "Law Commission") and fortuitously the Department of Trade and Industry ("DTI") proposed two projects, which were both accepted by the Law Commission.[22] The first was on shareholder remedies. Leaving aside unfair prejudice or oppression remedies or contributories' winding up on the just and equitable ground, a major task in this project was to create an up-to-date legislative scheme for shareholder actions.[23] The second project led to a report on directors' duties in which the Law Commission and the Scottish Law Commission jointly recommended that there should in principle be a statutory statement of the duties of directors.[24]

B. *The Department of Trade and Industry's Company Law Review*

30 This review was set up by the DTI[25] in 1998. There was a Steering Group of 15 members ("CLRSG"), widely drawn from company directors, the legal and accounting professions and economists. This author was a member of the CLRSG. It adopted a multidisciplinary approach, which meant that many areas were exposed to scrutiny by businesspeople and economists.[26] During the review, the CLRSG issued some nine consultation documents and one Final Report.

C. *The recommendation for a statutory statement of directors' duties*

31 The CLRSG recommended that there should be a statutory statement of directors' duties. It was not intended to replace the principles of the existing law but to make the law clearer and more accessible. The duties to be included were the familiar duties: to act in good faith in what the directors considered to be in the company's best interests, not to

22 This was the first time that the DTI had asked the Law Commission to make recommendations for the reform of the company law.

23 The Law Commission, *Shareholder Remedies* (Law Com No 246, 1997), which was issued in consultation with the Scottish Law Commission.

24 The Law Commission & The Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (Law Com No 261; Scot Law Comm No 173, 1999).

25 This abbreviation will be used to include the predecessor and successor departments of state, such as the Department of Trade and the Department for Business, Energy and Industrial Strategy.

26 Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Final Report* (Department of Trade and Industry, June 2001) at para 1.21.

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allow any conflict between interest and duty, to exercise powers for their proper purpose and not to fetter any discretion. The statement would also include the common law duty to exercise proper care and skill. In Singapore, directors' duties are still dealt with by the common law though the duty to be honest and to exercise skill and care and the duty not to make secret profits, which applies to all officers and agents, is dealt with by statute.[27]

32 The UK Government accepted this recommendation, and the necessary Bill was presented to Parliament. The core duty of loyalty was enshrined in s 172(1) of the Companies Act 2006 upon enactment. This article will focus on that provision. It contains material differences to the duty as previously expressed.

D. Significance of the reframing of the loyalty duty in section 172(1)

33 Section 172(1) of the Companies Act 2006 provides:

> **172 Duty to promote the success of the company**
>
> (1) A director of a company must 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 have regard (amongst other matters) to—
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.

27 Sections 157(1) and 157(2) of the Singapore Companies Act 1967 (2020 Rev Ed) provide:

> **As to the duty and liability of officers**
>
> **157**.— (1) A director must at all times act honestly and use reasonable diligence in the discharge of the duties of his or her office.
>
> (2) An officer or agent of a company must not make improper use of his or her position as an officer or agent of the company or any information acquired by virtue of his or her position as an officer or agent of the company to gain, directly or indirectly, an advantage for himself or herself or for any other person or to cause detriment to the company.

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34 At first sight, s 172(1) restates the previous law. Section 172(1) must be read with s 170(1), which provides that the directors' duties are "owed to the company". So, there is no duty owed to stakeholders. Section 172(1) does not impose any duty to *act* in the interests of stakeholders, nor does it contain any duty to balance their interests with those of shareholders.

35 Section 172(1) is thus expressed as a weak form of the stakeholder model. The duty is to *consider* the interests of stakeholders, laying particular emphasis on those with whom the company has relationships.

36 Now it would be possible to say that, as s 172(1) only imposes a duty to *consider* the interests of stakeholders, this duty is no different from the predecessor duty to act in what the directors consider to be the best interests of the company. This is supported by the fact that s 170(4) provides that "[t]he general law duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties". Before requiring directors to consider stakeholders' interests, s 172(1) states that the directors must act in the way that they consider in good faith would be most likely to promote the success of the company "for the benefit of its members as a whole". As to the obligation to consider the interests of stakeholders, it is not suggested that a person could successfully claim that there had been a breach of duty simply because directors fail to undertake the process of considering the interests of stakeholders.

37 However, the alternative view is that there has been a substantial change. The directors' duty is to consider the success of the company, thus emphasising the fact that the company is a separate entity. Stakeholders are an integral part of that entity. They are expressly mentioned, which provides some support for the impression that they are to have a status which they did not have under the previous law. Furthermore, in considering stakeholders' interests, the directors will have to discharge their statutory duty of skill and care. In all, as Lord Briggs explained in *Sequana*, s 172(1) "recognises that, as a separate entity from its shareholders, a company has responsibilities of a legal, societal, environmental and, in a loose sense, moral or ethical nature, compliance with which is likely to secure rather than undermine its success".[28]

38 In addition, Parliament has provided what is arguably a form of enforcement mechanism for the s 172 obligation to consider the interests of stakeholders. This is because it has imposed the obligation on

28 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [140].

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companies, other than small companies as defined, to make a strategic report which includes a statement explaining how directors have had regard to certain stakeholder interests as required by s 172(1).[29] However, one must not take this last point too far. As explained, s 170(1), like s 309 of the Companies Act 1985, makes it clear that the directors' fiduciary duties, including that in s 172(1), are owed to the company, and that means to the company alone. Only the company can enforce directors' duties by action.

E. Conclusion on the UK stakeholder model

39 The UK has taken steps to introduce a stakeholder model through its statutory statement of the duties of directors. It has imposed a duty on directors to consider the interests of stakeholders. Parliament would not have done this in vain or as an arid box-ticking exercise. The clear intention of imposing a duty to consider stakeholders' interests was to impose a duty to promote the success of the company for the benefit of shareholders through furthering the interests of stakeholders, *ie*, on the basis that the relationships which the company enjoys with its stakeholders are a critical factor, if not *the* critical factor, in ensuring the company's prosperity and viability. Slightly different considerations apply to creditors where the company has a further obligation, namely that of paying its debts as and when they fall due and, in certain circumstances, not taking steps to deprive them of their right to repayment. This article next turns to creditors.

IV. Directors' duties in relation to creditors: *BTI 2014 LLC v Sequana SA*

40 Curiously, s 172(1) of the Companies Act 2006 does not expressly mention creditors.[30] However, a special exception has been carved out for creditors in s 172(3). This provides:

29 This important document could identify the principal decisions the board has taken during the year, how regard was had to the s 172(1) matters when making decisions and the effect of that regard. Where there are conflicts between stakeholder interests, or where the interests of one group have been prioritised over another, the s 172(1) statement could explain how the directors have considered the different interests and the factors taken into account in making that decision. Some of these matters may be covered in Singapore by the Code of Corporate Governance.

30 The explanation for why creditors generally are not stated to be included in s 172(1) may be that purely in their capacity as persons to whom money is owed, they are not like the other persons mentioned in s 172(1). They are not stakeholders in the sense there meant because the company is obliged to pay them. Stakeholders usually means those affected by the company's operations without or in ways not limited to a legal debt or obligation enforceable by it. This then may be why creditors are not

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> **172 Duty to promote the success of the company**
>
> …
>
> (3) 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.

The UK Supreme Court had to consider the meaning of this provision in *Sequana*[31] – this author was a party to this decision.

A. BTI 2014 LLC v Sequana SA*: facts and issues*

41 The decision concerns the duty of directors in relation to creditors when the company is or may be insolvent. Exceptionally, although all the Justices agreed on the result, there were no less than four Justices who gave full judgments: Lord Reed, Lord Hodge, Lord Briggs (with whom Lord Kitchin agreed) and this author. Lord Reed gave the first judgment.

42 In considering the result it is helpful in this author's view to analyse the duty in relation to creditors in two parts. The first is the duty to consider the interests of creditors, which is akin to the duty of directors to consider the interests of any other group under s 172. The second is the duty to treat the interests of creditors as paramount, that is, as capable of displacing the interests of shareholders.

43 The case concerned a distribution which had been paid in May 2009 at a time when the company was considered to be solvent.[32] It later became insolvent. What had happened was that A Ltd, a UK registered company, made a distribution of nearly all its net assets to its parent company, Sequana SA, the first defendant. A Ltd had a major liability (the "environmental liability") in respect of clean-up costs as a result of the pollution of the Fox river in Wisconsin for which it was in some measure responsible. B plc was a contingent creditor of A Ltd as it had guaranteed an amount in or towards discharge of this liability. A Ltd duly followed the statutory procedure in Pt 23 of the Companies Act 2006 for quantifying the amount that might lawfully be paid by way

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mentioned in s 172(3). Or it may be a leftover from the philosophy that creditors are guardians of their own interests and can look after themselves. It seems, in this author's view, that they are covered in s 172(1) by implication where there is any reason to have regard to their position. In any event, where there is any conflict between the interests of the success of the company and those of creditors, they are covered by the special provisions of s 172(3) in circumstances of impending insolvency.

31 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709.

32 There were in fact two distributions, but this article need not separately mention the first in this summary of the facts.

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of distribution, including the preparation of relevant accounts. Some years after the distribution was made, it emerged that the environmental liability, which had been a contingent liability of A Ltd at all material times, was much greater than originally estimated, and A Ltd became insolvent.

44 There were two claims, but this article is only concerned with the first claim.[33] This was brought by the assignee of A Ltd against A Ltd's directors for breach of the duty in relation to creditors. This claim failed. The trial judge, Rose J, found that the distribution was lawfully made and that the risk of A Ltd's insolvency at the time of the distribution was not sufficient to trigger an obligation to creditors. At the time of the distribution, A Ltd was not insolvent or likely to become insolvent.[34] The Court of Appeal dismissed an appeal against the judge's rulings on this claim. The assignee appealed to the UK Supreme Court, contending that the directors had acted in breach of fiduciary duty because the distribution had been paid at a time when there was a real and not remote risk of insolvency because of outstanding pollution liabilities. The issue was whether that level of risk of insolvency was sufficient to trigger an obligation in relation to creditors not to make the distribution.

B. Principal issues in the UK Supreme Court

45 The assignee argued before the UK Supreme Court that directors were in breach of duty to creditors if they approved a distribution when there was a real and not remote risk that the company was insolvent. The UK Supreme Court considered the decision of the Court of Appeal in an earlier case – *West Mercia Safetywear Ltd v Dodd*[35] ("*West Mercia*"). This

33 The second claim was by B plc against A Ltd on the grounds that the May 2009 distribution was a transaction entered into with a view to defrauding creditors and thus fell within s 423 of the Insolvency Act 1986 (transactions defrauding creditors). This claim succeeded in relation to the second distribution, and the trial judge's decision was upheld on appeal. There was no further appeal relating to this claim to the UK Supreme Court.

34 There is nothing remarkable in the express requirements of Pt 23 of the Companies Act 2006 having this effect since it has long been established that, if the directors make a reasonable estimate of the financial position of the company and make a distribution on the basis of it, they will not be liable if the financial position is subsequently shown to have been materially overstated: see *In re Mercantile Trading Co* (1869) LR 4 Ch App 475. In that case, the directors of a ship owning company, engaged in a "hazardous trade" with Confederates during the American Civil War, made a distribution out of profits then reasonably thought to exist (insurance not being available) notwithstanding that the company subsequently incurred substantial losses when, *inter alia*, one of its ships was lost while trying to run a government blockade. The point in this case is that at the time of the distributions, the directors carefully considered the liabilities of the company and formed the judgment in good faith that the distributions would not prevent their payment.

35 [1988] BCLC 250.

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was said to establish that directors owed a duty to creditors when it was clear that their company would have to go into insolvent administration or liquidation. The UK Supreme Court also had to consider provisions of the Companies Act 2006. Sequana SA argued that there were no circumstances in which directors owed a duty in relation to creditors. There were issues as to the content of any duty and when it arose and whether it applied to the payment of a lawful distribution in any event.

C. Controversiality of the underlying issues in the Company Law Review

46 The duties of directors of prospectively insolvent companies had been a highly contested issue during the DTI's Company Law Review and that expert body had been unable to reach agreement as to the content of any duty owed by directors when the company is approaching insolvency. The details of this were explained in Part 2 of this author's judgment In *Sequana* – this author's view is that it would assist courts in the future to understand that the question whether and, if so, what duties directors owed in that situation was a very difficult and sensitive practical issue.

47 The principal reasons why the CLRSG was unable to reach a view on the content of this duty were as follows. On the one hand, it was considered that it should be the duty of the directors, if there was a substantial *probability* of liquidation, to take such steps as they considered in good faith appropriate to reduce the risk without undue caution and thus continue to have in mind the interests of members. This would involve a sliding scale: the greater the risk of insolvency, the more directors should take creditors' interests into account. The interests of creditors only overrode those of members when there was no realistic possibility of avoiding insolvent liquidation. On the other hand, it was considered that this rule would have a chilling effect: fears of personal liability would lead to excessive caution. It would demand a difficult and indeterminate exercise of judgment. Liquidation could be as damaging to creditors as to members. The insuperable difficulty which could not be resolved by the drafting was that the principle gave inadequate guidance and relied on directors being able to discern an intermediate stage on the path to insolvency, which was not identifiable in reality. The break from going concern to an insolvent basis of trading is normally rapid so that references to calculating probabilities and to sliding scales of benefit were considered unhelpful.

48 The UK Government recognised that the common law was uncertain and was also concerned that the duty should not have a chilling effect on the scheme for the rescue of insolvent companies. So, its solution was s 172(3), which Parliament enacted. As a matter of interpretation this

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might mean that it was an open question whether there was any relevant rule of law, or it might mean that Parliament endorsed the existence of a duty but without defining its contents or limits. This author took the former view, but nothing significant turns on this difference.

D. Principal issues decided in **BTI 2014 LLC v Sequana SA**

49 The kernel of the decision in *Sequana* is that directors owe a duty to consider the interests of creditors when the company is insolvent or bordering on insolvency.[36] Once the company becomes irreversibly insolvent, the interests of the creditors will be paramount, that is, be capable of displacing the interests of the shareholders if inconsistent with creditors' interests.[37] The UK Supreme Court approved the earlier and brief decision of the Court of Appeal in *West Mercia*,[38] which established that a director owed a duty to have regard to the interests of creditors (in that case when making a voidable preference to a creditor on the eve of liquidation). *West Mercia* followed decisions in Australia and New Zealand and was also followed in the English courts in later cases. In this context, the interests of the creditors meant the interests of the class of creditors, and not the interests of any individual creditor.

50 The UK Supreme Court also considered that the duty in relation to creditors received support from the established restrictions on shareholder ratification of a breach of duty. Shareholders cannot ratify a breach of duty if it would lead to the company's insolvency, and this is consistent with the duty of directors in relation to creditors.[39]

51 While their duty was no more than to consider the interests of creditors, the directors had to balance the interests of creditors and shareholders. This will be highly fact-sensitive and "much will depend upon the brightness or otherwise of the light at the end of the tunnel".[40] The obligations to creditors would increase as the insolvency worsened. This author pointed out that this sliding scale should not be taken too literally since the progress to insolvency might not be linear. If the

36 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [81], *per* Lord Reed, at [227], *per* Lord Hodge, at [176], *per* Lord Briggs, with whom Lord Kitchin agreed and at [250], *per* Lady Arden.

37 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [11] and [80]–[81], *per* Lord Reed, at [242], *per* Lord Hodge, at [166]–[177], *per* Lord Briggs, with whom Lord Kitchin agreed and at [291], *per* Lady Arden.

38 *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.

39 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [91], *per* Lord Reed, at [207], *per* Lord Hodge, at [149], *per* Lord Briggs, with whom Lord Kitchin agreed and at [312]–[316], *per* Lady Arden.

40 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [176].

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financial position improves and then worsens, the directors may have to adjust the priorities to be given to creditors and shareholders.

52 There was a difference of view on the UK Supreme Court in relation to culpability thresholds. The majority held that the duty became engaged when the directors knew or ought to have known that the company is insolvent or bordering on insolvency.[41] The minority left open the question whether this duty depended on the knowledge which the directors had or ought to have had.[42] If in the future the position is established that the duty arises on insolvency, irrespective of knowledge of insolvency, the director may be able to rely on his or her lack of knowledge as a basis for holding that the director should be excused from liability.[43]

53 The directors' duty in relation to creditors thus excluded the interests of shareholders only when liquidation or administration became unavoidable or irretrievable. The substantial body of jurisprudence in Australia and New Zealand had not spoken with one voice on this point in time at which the duty arose.[44] According to *Sequana*, the time when an insolvency procedure becomes inevitable is the tipping point. The duty to give priority to creditors' interests over those of shareholders is thus engaged in much the same circumstances as liability for wrongful trading. There is no justification for the duty beginning at any earlier point in time simply because the company is insolvent. As Lord Briggs pointed out, a start-up company is often balance sheet insolvent and in any event a company can have a temporary cash flow shortage as a result of an unexpected event, like the COVID-19 pandemic.

54 There was a difference between the views held by the UK Supreme Court and the views of the Court of Appeal on this "tipping point". The Court of Appeal held that as soon as a company was insolvent, the directors' duty in relation to creditors became paramount and displaced their duty to act in the company's interests. This is an important point, because the practical consequence of the Court of Appeal's view is that directors must ignore the interests of shareholders on insolvency even if it is in the company's best interests to take steps to bring an end to

41 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [207] and [231], *per* Lord Hodge and at [203], *per* Lord Briggs, with whom Lord Kitchin agreed.
42 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [90], *per* Lord Reed and at [278]–[281], *per* Lady Arden.
43 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [281], *per* Lady Arden.
44 Compare, *eg*, *Kinsela v Rusell Kinsela Pty* (1986) 4 NSWLR 722, which referred to the duty arising "in an insolvency context" whereas in *Grove v Flavel* (1986) 43 ASLR 410, in which the Full Court of the Supreme Court of Australia considered that the duty arose when there was a real and not remote risk of insolvency.

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the insolvency. The UK Supreme Court disagreed with the Court of Appeal, and held that the moment when creditors' interests displace those of shareholders only occurred when liquidation or administration became inevitable.

55 The decision of the UK Supreme Court here does not effect any great change for directors over the law apart from *Sequana* because at the tipping point, the directors would be potentially under a liability for wrongful trading.[45] As soon as the duty became paramount, directors could not act other than in accordance with creditors' interests. On the other hand, so long as insolvent liquidation or administration is not inevitable, directors will still be able to promote a corporate rescue if they consider that this was in the best interests of both creditors and shareholders.[46]

56 There was some discussion of the meaning of "insolvency". It was clear that it included both commercial (cash flow) insolvency and balance sheet or deficiency of assets. Lord Briggs considered that the situation where the insolvency which was purely transitory (as in the case of a start-up company) would be a case of where there was "light at the end of the tunnel" so that less weight would be given to the interests of creditors.

57 Moreover, the UK Supreme Court rejected the contention that a duty in relation to creditors would conflict with wrongful trading and other insolvency provisions. Those provisions are unaffected. A transaction could be in breach of s 423 of the Insolvency Act 1986[47] even if it was not also in breach of the duty in relation to creditors.

58 As to the juristic nature of the duty, the UK Supreme Court decided that directors owed a duty in relation to creditors by way of extension or modification of the normal fiduciary duties of directors. That means that the duties in relation to creditors remain duties owed to

45 Section 214(2) of the Insolvency Act 1986 provides:

> **214 Wrongful trading**
>
> …
>
> (2) This subsection applies in relation to a person if—
>
> (a) the company has gone into insolvent liquidation,
>
> (b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or entering insolvent administration, and
>
> (c) that person was a director of the company at that time …

46 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [58], *per* Lord Reed, at [238], *per* Lord Hodge and at [248], *per* Lady Arden. Lord Briggs also considered that the duty in relation to creditors was consistent with the rescue regime (at [151]).

47 c 45 (UK).

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the company and enforceable as other such duties. Under UK law, only members can bring derivative actions.[48] Under s 216A of the Singapore Companies Act 1967, by contrast, the class of persons permitted to bring derivative actions includes persons authorised by the court and so could be wider.

59 The UK Supreme Court unanimously rejected the view that there was any duty to creditors in their own right. This author's judgment cited a passage from a paper written by Richard Sykes QC (while a member of the CLRSG) which said that directors cannot sensibly make decisions if they have two masters. At the other end of the spectrum, the UK Supreme Court rejected the argument that directors owed duties to shareholders alone and that there was no duty in relation to creditors.

60 The conclusion of the UK Supreme Court was founded on the reservation in s 172(3) of the Companies Act 2006, which provides that "[t]he 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 the creditors of the company". This provision either (according to the majority) reaffirmed a duty which already existed in consequence of the decision in *West Mercia*, or (according to the minority) preserved any rule of law if and to the extent that it existed.[49] The UK Supreme Court considered that the existence of the duty was justified by a shift in economic interest from the shareholders to the creditors as a company becomes insolvent and as that insolvency worsens.[50] It rejected reasoning in earlier cases that a duty in relation to creditors sprang from any concept of an existing or prospective proprietary interest in the company's assets, as creditors do not have such an interest.[51] Nonetheless, Lord Reed stated on three occasions in his judgment that creditors remained the "guardian" of their own interests in most situations.[52] They could ask for special contractual protections (but not if they were involuntary creditors of course). That is an important plank in the scheme of limited liability companies, as explained earlier. The duty established in *Sequana* to consider the interests of creditors is only engaged when the company is insolvent or bordering on insolvency.

48 See s 260 of the Companies Act 2006.
49 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [209], *per* Lord Hodge and at [153], *per* Lord Briggs, with whom Lord Kitchin agreed, *cf*, at [71], *per* Lord Reed and at [344]–[345], *per* Lady Arden.
50 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [59], *per* Lord Reed, at [246], *per* Lord Hodge, at [147], *per* Lord Briggs, with whom Lord Kitchin agreed and at [256], *per* Lady Arden.
51 See n 41.
52 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [27], [28] and [52].

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On this, various phrases were used by the Justices but, as Lord Reed held, the formulations are not different in substance.

61 The directors' duty in relation to creditors could be engaged by the payment of a distribution even if the distribution complies with Pt 23 of the Companies Act 2006. However, applying the principles set out above, the UK Supreme Court unanimously held that it was not enough that there was only a real and not remote risk of insolvency. Therefore, on the facts of this case, the duty was not engaged, simply because there was no more than a real and not remote risk of insolvency at the time of the relevant decision. The UK Supreme Court thus came to the same result as the Court of Appeal though for different reasons on the key point of the trigger for the duty.[53]

62 This author's judgment was the fourth judgment, and began by observing that *Sequana* is a "momentous … decision for company law". Although 247 paragraphs had to be read before reaching this author's judgment, many commentators have fastened on this phrase and agreed with it. This author went on to refer to Lord Mansfield, one of the finest commercial judges in the UK, and to his practice of sitting with a commercial jury because he valued the opinions of commercial men as to the practical solutions for legal problems. This was intended to underline that the law which governs the duties of directors when their company faces insolvency must be practical and workable. Members of the court accepted that this was an area where priority had to be given to clarity and practicality.[54]

63 In dealing with the stage when a company has become insolvent, but not irretrievably so, this author also held that, when directors had to consider the interests of both shareholders and creditors, this did not mean that they did not also have to consider other stakeholder interests, such as those of employees. They would have to be factored into the decision. This is another way of saying that, if there are other stakeholders whose interests fall to be considered as a way of achieving the best interests of

53 Because that was the simple answer to the case, much of the judgments are strictly *obiter dicta* but as Lord Hoffmann once said, there are *obiter dicta* and *obiter dicta*: see *R (Godmanchester Town Council) v Secretary of State for the Environment* [2008] AC 221 at [21]–[22].

54 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [87], *per* Lord Reed, at [173], *per* Lord Briggs and at [250] and [448], *per* Lady Arden. Lord Hodge held at [234]: "But that does not mean that the courts should ignore the concerns expressed by some members of the CLRSG as to the uncertainty which this duty may create for directors in their decision-making. The common law in this area must be developed with care and in a manner consistent with the predominant statutory regime for corporate insolvency."

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the company, the directors must also take those interests into account. But this was not a point considered by the other members of the court. This author added that the way directors did this was a matter for their discretion.[55]

64 This author issued a strong warning that directors had to stay informed about the financial position of their company[56] and further held that, when the directors had a duty to consider the interests of creditors, their duty was no more than to refrain from causing them any material harm. They did not have to take positive steps to enhance their position.[57] This author pointed out that, while it was helpful to consider the balancing of the interests during this period, in practice the slide into insolvency was not linear.[58]

65 This author went on in her judgment to describe in more detail the principle which had been so influential in the work of the CLRSG, namely enlightened shareholder value.[59] The expression "for the benefit of its members" reflects the fact that if the company succeeds it will create funds which are distributable not to creditors but to members. The duty in s 172(1) is the successor to the duty of directors as traditionally stated.[60] The statement of duties includes a duty of care. The Law Commissions produced the draft for this. The other duties in the statutory statement were the work of the CLRSG. All the duties of the company are owed to the company and not to any individual member or stakeholder.[61]

66 This author explained in her judgment that the duty in s 172(1) was based on shareholder primacy, modified so as to constitute what was called "Enlightened Shareholder Value" or "ESV". The history of the Company Law Review showed that the CLRSG considered whether companies should be founded on shareholder primacy, modified as ESV, or on a pluralist model. The first model states that the duties of directors are to promote the success of the company for the benefit of members. By contrast, under the pluralist model, a company is also responsible to several separate constituencies additional to shareholders, such as employees, suppliers, consumers and the community. The pre-legislative history shows that the CLRSG considered that the appropriate model was shareholder primacy, qualified by an obligation to consider the interests of suppliers, employees and others. The Government had accepted this

55 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [294]–[303].
56 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [304].
57 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [288]–[290].
58 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [303].
59 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [371]–[386].
60 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [386].
61 See s 170(1) of the Companies Act 2006.

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view.[62] This author substantiated this in her judgment with a detailed account of the pre-legislative history. The fact that the Companies Act 2006 adopted the principle of shareholder primacy enabled this author to conclude that there was no question of the directors owing a duty to creditors as such.[63]

V. A new lens on the question

67 Stakeholders now have a toe in the boardroom door and indeed, in the case of creditors, the obligations owed to them may go deeper. Creditors are certainly one group of stakeholders. So far as UK law is concerned, *Sequana* breaks the mould. It had long been established that the protection of the interests of stakeholders could be part of a company's purpose if the protection or promotion of their interests was in the interests of the company. But looking at the position of stakeholders through the lens provided by *Sequana*, it is clear that the protection and promotion of the interests of at least one group of stakeholders can in itself be part of the company's purpose and indeed can displace the promotion of the interests of shareholders. That is why this author says that *Sequana* breaks the mould.

68 *Sequana* and the analysis of creditor rights demonstrates the following:

> (a) All legal systems have to deal with unpaid creditors. There is a fork in the road for common law jurisdictions – they can hold that it is no part of the duties of directors to have regard to creditors. The Supreme Courts of Delaware and Canada have so held. The Supreme Court of Delaware considered that creditors have sufficient specific remedies and should not be able to challenge directorial action.[64]
>
> (b) Other jurisdictions take a more beneficent view of duties in relation to creditors. In *Sequana*, the UK Supreme Court consolidated, refined and clarified the jurisprudence supporting that view. It is this author's hope that *Sequana* will have great influence globally because of the depth in which these issues were considered – albeit mainly *obiter*.
>
> (c) In general, the pursuit of stakeholder interests turns on the exercise by directors of their discretion. But the position

62 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [372].
63 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [265].
64 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [248] and [300]–[301].

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of creditors, as analysed in *Sequana*, shows that there are some situations where it is not possible to leave the matter to discretion.

(d) Section 172(1) does not impose any mandatory obligation on directors to take any particular action in favour of a group of stakeholders, but *Sequana* shows that, if the Legislature chose to impose such an obligation in appropriate terms, there is no reason to think that it could not have been enforced.

(e) In that situation companies legislation might have achieved the transformation of the limited company from an entity for wealth creation to a plural entity which makes profits not just for investors but also for other stakeholders. The potential for a move to wider stakeholder duties is clear.

69 An example will show how important this development might be. Suppose the board of directors of a company decides to sell one of the company's subsidiaries, and it receives two competing offers. Bidder 1 is willing to pay the higher price but would reduce the workforce and subcontract manufacturing to low-cost manufacturers in developing countries which will lead to higher profits. Bidder 2 offers a smaller sum but would leave current manufacturing operations unchanged. That would benefit the employees but not the shareholders. The directors decide to take the lower offer because it is better for the employees. If the directors are bound to secure the success of the company, then Bidder 1's offer would seem to be the offer they should accept. But if the directors owe duties not just to shareholders but also to other stakeholders such as employees, they may take the view that the proper balance between the two sets of interests may require them to take Bidder 2's offer.

70 At all events *Sequana* is an important authority on the fiduciary duty of directors in relation to creditors. It clarifies that that duty extends to creditors' interests and can displace the duty to shareholders if liquidation becomes unavoidable. Before that point in time, when a company becomes insolvent, the interests of creditors are interests which must be balanced against those of shareholders if different from them.

71 It also contains a wider message. It enables us to see the development of company law in the three eras that have been mentioned. The first era was unvarnished wealth creation. The second era was wealth creation qualified by a wider view of best interests and a duty to creditors in very limited circumstances. The third era may seek to build on that by holding that there are other stakeholders to whom directors owe duties. This is a dynamic area of law which may lead to further developments to raise the status of stakeholder interests for the purpose of directors' duties.

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VI. Words of caution

72 This article concludes with two notes of caution. The first is, under the UK model, the choice of whether to benefit stakeholders will depend to a substantial extent on the discretion of the directors. So long as the extension is only a discretion, it is largely under the control of the directors. This is reinforced by the fact that the fiduciary duty is always subjective. In that respect, s 172(1) reflects the position at common law.

73 The second word of caution is that the decision as to what interests in a company directors should serve, or what a company is for, is likely to be a matter for the Legislature. In making any change in the law there are likely to be economic arguments and other arguments of policy to weigh up. This author would not suggest that the move to a pluralistic stakeholder model can be done by judges alone. In the UK at least, legislation would be needed. Judges alone are in general not able to adjudicate on matters of contested industrial or business policy. Careful consideration of many points would be needed. There would for instance have to be a solution to the difficulties raised by Richard Sykes QC in a passage which was cited in this author's judgment:[65]

> A regime in which directors found themselves owing different duties to several different 'masters', some with interests conflicting with those of others, would make it extremely difficult for directors to decide what weight to give to each of the duties concerned.

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65 *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709 at [266]. This quotation contemplates a difference of duty and conflicting interests. This author added that there may be situations in which it is possible to serve two masters, *eg*, where duties to serve different masters fell to be performed separately from each other and do not collide, but *Sequana* did not concern one of those situations.

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