ALERTS

UK Directors' Duties – What Are You Owed as a Creditor, and When?

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The UK Supreme Court issued a key judgement on 5 Oct.[1] which clarifies the law relating to when directors of a UK company need to consider the interests of creditors.

The UK Companies Act 2006 enacted, for the first time, a partial codification of directors' duties[2]. That codification was "partial" as the codified duties were expressly based on prior common law rules and equitable principles, and as those duties were to be interpreted and applied in the same way as the existing common law rules and equitable principles.

However, the codification did not deal with how, when and to what extent directors might owe duties to creditors of the company, or to consider their interests, though it expressly made it clear that the duty to promote the success of a company for the benefit of its members (i.e. shareholders) as a whole was "subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors ..."[3].

Prior to the Supreme Court judgement, case law had suggested that directors owe duties in some circumstances (i.e. where a company is insolvent or on the verge of insolvency) to consider the interests of creditors as well as shareholders, and even that such a duty may be enforceable by creditors directly. There was also uncertainty as to how early that duty might arise when a company has some degree of actual or anticipated financial difficulty.

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The Supreme Court's judgement clarifies that the directors of a UK company are duty bound to consider the interests of creditors when: (a) the company is "insolvent or bordering on insolvency" or (b) where an actual insolvent liquidation or administration is probable. Where an actual insolvency or administration is not inevitable, the director's duty to promote the success of a company for the benefit of its members as a whole will remain relevant, but the directors will need to balance the interests of creditors and shareholders and act accordingly. It was also clarified that (i) there was no duty to consider the interests of creditors (absent the circumstances above) if it is more likely than not that the company will at some point be unable to pay its debts as they fall due and (ii) there was a sliding scale in determining the priority of members' as opposed to creditors' interests, such that the worse the financial situation of a company is, in other words the more probable an insolvent liquidation or administration becomes, the more the directors should prioritise the interests of creditors over those of its members.

Finally, it was confirmed that there was no separate "creditor duty" imposed on directors, the core duty remains a duty to act in good faith in the interests of the company, but in the circumstances described above the directors must consider the interests of creditors along with those of members. It therefore follows that the duty is owed (where it is owed at all) in respect of creditors generally and not to them individually (or as a sub-class), and that the duty is owed to the company and cannot, other than through a liquidator or administrator, be enforced by the creditors directly.

For managers holding debt instruments of a UK company, the directors will not usually be bound to specifically consider your interests save where the company is insolvent or bordering on insolvency, or where such event is probable. However, in those circumstances, the personal nature of (and personal liability attaching to) director's duties should weigh on the minds of directors, and managers should not be shy in reminding them of that accordingly where circumstances warrant it. In particular, where this duty does arise, it will bear on the director's consideration of whether they should authorise or recommend the payment of a dividend (even when the accounts show sufficient distributable reserves).

Authored by Jim McNally.

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[1] UKSC 2019/0046 (BTI 2014 LLC v. Sequana SA)

[2] Chapter 2, Companies Act 2006.

[3] Companies Act 2006, s.172(3).

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