Restructuring and Insolvency

BTI v Sequana: What the UK Supreme Court Decision Means for Malaysia

Introduction

On 5 October 2022, the UK Supreme Court delivered its long-awaited judgment in *BTI 2014 LLC v. Sequana SA and others* [2022] UKSC 25 ("***Sequana Case***") which concerns the question of the trigger point when directors must have regard to the interests of creditors ("**Creditor Duty"**). This case raised questions of considerable importance for Malaysian company law.

The UK Supreme Court in the *Sequana Case* considered for the very first time, the existence, content, and engagement of the Creditor Duty. The Supreme Court effectively confirmed the existence of the Creditor Duty in the arena of insolvency and held that the Creditor Duty is engaged when the directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation or administration is probable.

In this Update, we summarise the legal issues and decision of the UK Supreme Court and discuss the possible impact of the *Sequana Case* for Malaysian companies.

Brief Facts

In May 2009, the directors of a company known as Arjo Wiggins Appleton Limited ("**AWA**") caused AWA to distribute a dividend of €135 million ("**May Dividend**") to its only shareholder, Sequana SA ("**Sequana**"), which extinguished by way of set-off almost the whole of a slightly larger debt which Sequana owed to AWA.

The May Dividend was distributed when AWA was solvent on both balance sheet and cash flow basis. However, it had long-term pollution-related contingent liabilities of an uncertain amount and an insurance portfolio of an uncertain value.

Almost ten years later, AWA went into insolvent administration sometime in October 2018.

BTI 2014 LLC ("**BTI**"), as assignee of AWA's claims, sought to recover the May Dividend from AWA's directors on the basis that their decision that AWA distributes the May Dividend was a breach of the Creditor Duty because the directors had not considered or acted in the interests of AWA's creditors.

Decision

This claim was rejected by the High Court and the Court of Appeal. The Court of Appeal (*[2019] EWCA Civ 112*) held that the Creditor Duty may be triggered in circumstances short of actual insolvency namely, the said duty arises when the directors know or should know that the company is or is likely to become insolvent.

The Supreme Court unanimously dismissed BTI's appeal and confirmed that the Creditor Duty arises under certain circumstances, namely (i) when the directors know or ought to know the company is insolvent or bordering on insolvency; (ii) where an insolvent liquidation or administration is probable; or (iii) where the transaction in question would place the company in either of the foregoing two situations. On the facts of the *Sequana Case*, the Creditor Duty was not triggered as the company was not actually or imminently insolvent nor was insolvency probable at the time.

Summary of the Salient Legal Issues

1) Whether there is a common law Creditor Duty at all?

Section 172(1) of the UK Companies Act 2006 requires directors to act in the way 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. Under common law, directors are in a fiduciary position to act in good faith in the interests of the company and exercise their powers *bona fide* for the benefit of the company as a whole. In *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 ("***West Mercia***"), the English Court of Appeal modified the ordinary rule by including the interests of the creditors as a whole under the company's interests. The rationale for this is that a company's creditors have an economic interest in the company based on their entitlement to be paid their debts. The importance of the economic interest of the company's creditors increases when the company is insolvent or nearing insolvency. As such, directors are required to manage the company's affairs in a way which takes creditors' interests into account.

The Supreme Court agreed that the common law does establish that under certain circumstances, directors are required to take into account the interests of creditors. The Court also held that the Creditor Duty is not a free-standing duty on its own - instead it is part of the directors' fiduciary duty to the company.

2) What is the content of the Creditor Duty?

Where the company is insolvent, or bordering on insolvency, but is not faced with an inevitable insolvent liquidation or administration, the duty of the directors includes taking into account the interests of creditors as well as the interests of the general body of shareholders, and to act accordingly. Where their interests are in conflict, a balancing exercise will be necessary. The interests of creditors are essentially the interests of creditors as a general body and directors are not required to consider the interests of particular creditors. It was acknowledged by the Supreme Court that any course of action to be taken by directors of companies faced with potential insolvency is a fact sensitive question which requires a weighing of interests and exercise of judgment.

The Supreme Court further recognised that where an insolvent liquidation or administration is inevitable, the creditors' interests become paramount.

3) When is the Creditor Duty engaged?

On the facts of the *Sequana Case*, the Creditor Duty was not engaged, as at the time of the May Dividend, AWA was not actually or imminently insolvent, nor was insolvency even probable.

The majority of the Supreme Court held that the Creditor Duty is engaged when directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation or administration is probable.

How will this impact the Malaysian position on Directors' Duties Towards Creditors?

1) The Position in Malaysia

In Malaysia, a director's duty to the company is provided under the Companies Act 2016 ("**CA 2016**"). Section 213 of the CA 2016 provides that: -

"*(1) A director of a company shall at all times exercise his powers in accordance with [the CA 2016], for a proper purpose and in good faith in the best interest of the company*

(2) A director of a company shall exercise reasonable care, skill and diligence with –

- *(a) the knowledge, skill and experience which may reasonably be expected of a director having the same responsibilities; and*
- *(b) any additional knowledge, skill and experience which the director in fact has.*"

Malaysian Courts have followed the common law position in *West Mercia*, as seen in the High Court case of *Tradelift Indopalm Industries Sdn Bhd v Waris Selesa Sdn Bhd* [2017] 1 LNS 2074, where the High Court dealt with the interest of creditors of an insolvent company. The High Court concluded on the facts of the case that where the plaintiff company was considered insolvent, the interests of the creditors of the plaintiff company displaced that of its members.

Similarly, the High Court in *Dan-Bunkering (Singapore) Pte Ltd v The Owners of the Ship or Vessel "PDZ Mewah" & Anor* [2020] 1 LNS 1966 acknowledged the principle that when a company is insolvent, directors must have regard to the interests of creditors. Both of these cases effectively acknowledged the common law position laid down in *West Mercia*.

Notwithstanding that **Section 213 of the CA 2016** does not deal with directors' duties vis-à-vis the interests of creditors, the Malaysian Courts have accordingly acknowledged the common law position that directors must have regard to the interests of creditors when a company is insolvent.

It is necessary to note that CA 2016 also contains provisions that touch on protecting the interests of creditors. This, *inter alia*, includes **Sections 131 and 132 of the CA 2016** which deal with distribution of profits to the shareholders by way of issuance of dividends and **Sections 539(3) and 540 of the CA 2016** which deal with the liability for wrongful and fraudulent trading, respectively.

2) Impact on Malaysian Landscape

There is limited guidance on the Creditor Duty in respect of companies that are nearing insolvency as opposed to when companies are already insolvent. Therefore, the exact scope/limit of the Creditor Duty and when it arises have not been fully considered and examined by the Malaysian Courts.

The decision in the *Sequana Case* is likely to be highly persuasive and may have a significant bearing on the development of the law in this area in Malaysia. However, for directors trying to understand the practical implications of when a company's insolvency is "imminent", or where its insolvent liquidation or administration becomes probable, the timing of when the Creditor Duty is engaged (i.e. triggered) remains fact specific and is subject to future case law development.

Steps Directors Should Take When Company is in Financial Distress

Given the current economic and business conditions, where a company is in financial distress and potentially facing the threat of imminent/probable insolvency, directors should consider taking the following steps:

(a) staying fully informed and mindful of the financial health of the company. Directors ought to have full access to all information that is necessary to make informed decision(s) as this will have a significant impact on the weight to be accorded to creditors' interests;
(b) taking professional legal advice to support the board of directors' understanding and exercise of its duties;
(c) seeking appropriate specialist financial advice on the assessment of the company's financial position in relation to refinancing, restructuring or insolvency options; and
(d) holding frequent board meetings to assess the financial position of the company and whether the company should continue to trade and documenting in the board minutes the reasons for decisions taken.

Conclusion

The *Sequana Case* is an important development, especially since the *Sequana Case* has recognised that the Creditor Duty is part of the common law. Such a recognition provides Malaysian Courts with a basis to import the Creditor Duty since developments in the common law can be considered and adopted in Malaysia. Any adoption of the decision in the *Sequana Case* may be viewed as a welcome development by creditors in Malaysia, although this does result in a widening of the fiduciary duties of directors of companies.

If you have any queries or require any guidance in relation to the above, please feel free to contact our team members below who will be happy to assist.

Key Contacts

John Mathew
Partner

T +603 2267 2626
M +601 2377 7792
john.mathew
@christopherleeong.com

Chua See Hua
Partner

T +603 2273 1919
M +601 2311 3666
seehua.chua
@christopherleeong.com

Heng Yee Keat
Partner

T +603 2267 2723
M +601 7278 0107
yee.keat.heng
@christopherleeong.com

Contribution Notes

This Update is contributed by the Contact Partners listed above with the assistance of **Saresh Mahendaren**, (Associate, Christopher & Lee Ong), **Ooi Tian Hong** (Associate, Christopher & Lee Ong) and **Yiew Xiu Ning** (Associate, Christopher & Lee Ong).

Our Regional Contacts

RAJAH & TANN | *Singapore*
Rajah & Tann Singapore LLP
T +65 6535 3600
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*
R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN 立杰上海
SHANGHAI REPRESENTATIVE OFFICE | *China*
Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*
Assegaf Hamzah & Partners

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4550
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | *Lao PDR*
Rajah & Tann (Laos) Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*
Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

RAJAH & TANN | *Myanmar*
Rajah & Tann Myanmar Company Limited
T +95 1 9345 343 / +95 1 9345 346
F +95 1 9345 348
mm.rajahtannasia.com

GATMAYTAN YAP PATACSIL
GUTIERREZ & PROTACIO (C&G LAW) | *Philippines*
Gatmaytan Yap Patacsil Gutierrez & Protacio (C&G Law)
T +632 8894 0377 to 79 / +632 8894 4931 to 32
F +632 8552 1977 to 78
www.cagatlaw.com

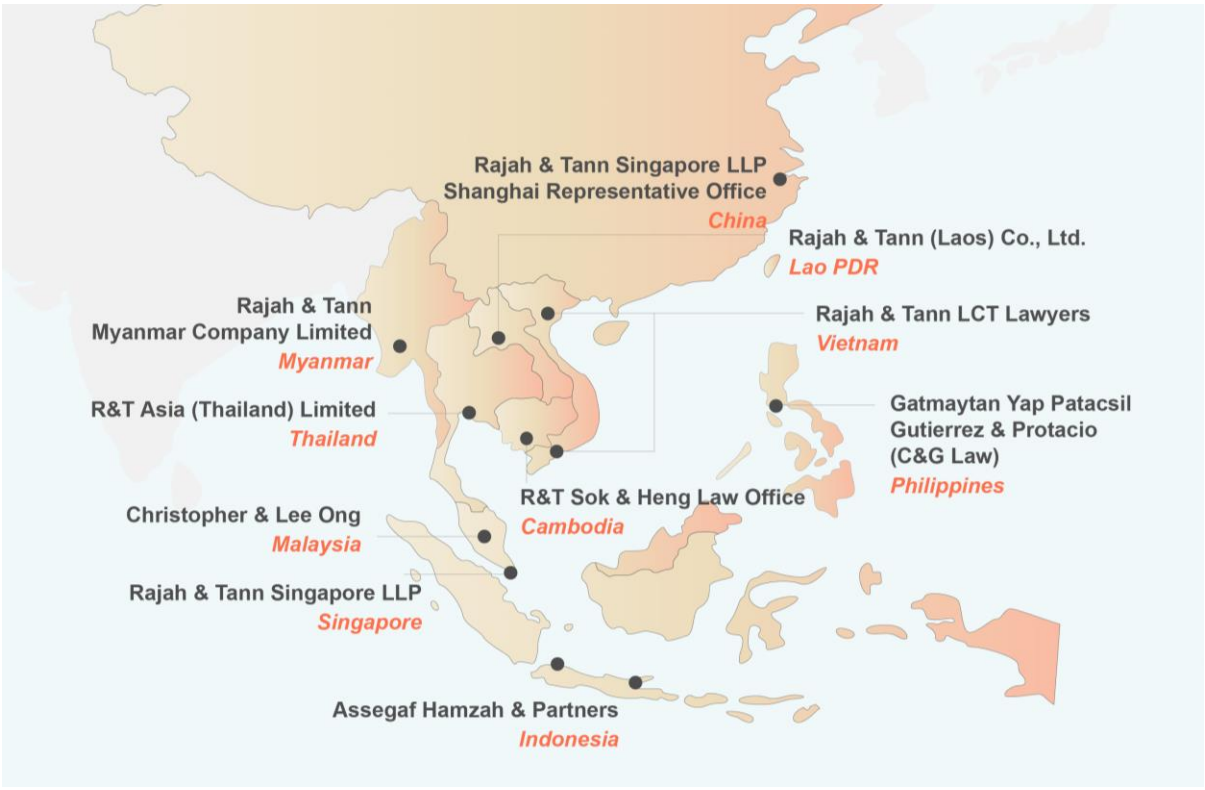
RAJAH & TANN | *Thailand*
R&T Asia (Thailand) Limited
T +66 2 656 1991
F +66 2 656 0833
th.rajahtannasia.com

RAJAH & TANN LCT LAWYERS | *Vietnam*
Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
T +84 28 3821 2382 / +84 28 3821 2673
F +84 28 3520 8206

Hanoi Office
T +84 24 3267 6127
F +84 24 3267 6128
www.rajahtannlct.com

Our Regional Presence



Christopher & Lee Ong is a full service Malaysian law firm with offices in Kuala Lumpur. It is strategically positioned to service clients in a range of contentious and non-contentious practice areas. The partners of Christopher & Lee Ong, who are Malaysian-qualified, have accumulated considerable experience over the years in the Malaysian market. They have a profound understanding of the local business culture and the legal system and are able to provide clients with an insightful and dynamic brand of legal advice.

Christopher & Lee Ong is part of Rajah & Tann Asia, a network of local law firms in Singapore, Cambodia, China, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Thailand and Vietnam. Our Asian network also includes regional desks focused on Brunei, Japan and South Asia.