

BTI 2014 LLC v Sequana SA: unanswered questions from a British Virgin Islands perspective

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Sequana

Both common law and the (UK) Companies Act, 2006 impose on company directors a duty to act in good faith to promote the company's success. The traditional view is the company's interests are synonymous with the interests of the company's shareholders. But in recent decades, the law began to acknowledge that when the company approaches insolvency or becomes insolvent, the interests of a company's creditors could be affected by the management of the company. Accordingly, the law began to impose a duty on directors to consider the interests of creditors when discharging their fiduciary duties to the company in insolvency contexts. This rule, known as the *West Mercia* rule (derived from *West Mercia Safetywear Ltd (in liq) v Dodd* [1988] BCLC 250), was never consistently explained in case law. Additionally, the language used by the courts often caused confusion about the nature of the rule and the precise circumstances in which it arose.

In *Sequana*, the Supreme Court held that the so-called rule in *West Mercia* did not create a new directors' duty towards creditors; there is no separate "creditor duty" which can be enforced by them, despite wide use of that term. Instead, the rule in *West Mercia* modifies the traditionally understood duty of directors to the company. For so long as the company is financially stable, the directors' duty to promote the company's success encompasses the interests of the shareholders. However, when the company reaches a point where it is insolvent (on a cash flow or balance sheet analysis), or its insolvency is imminent, the directors must begin to take into account the interests of the creditors as well as the shareholders when discharging their duties to the company. The interests of both are to be

weighed and considered. At this point, the company may successfully trade its way out of its predicament. However, when the company's insolvent liquidation becomes unavoidable, the interests of the shareholders fall away, and the creditors' interests become paramount.

The rule in *West Mercia* is premised on a shift in the company's economic interests and the distribution of risk among the shareholders and creditors. While the company is solvent, the risk of any action taken by the management is borne by the shareholders, who may see a fall in the value of their shares or any prospective distribution. Where the company approaches insolvency, the creditors bear much, if not all, of the risk.

This is an important decision for directors of UK companies to bear in mind, particularly in the current challenging market.

It is important to note another two key features of the judgment. First, the Court was silent on whether it was necessary to show that the directors knew or ought to have known the company was insolvent or that an insolvent liquidation was unavoidable. However, the *Sequana* decision will be an added incentive for directors to review the company's solvency periodically, if not regularly. Secondly, the Court was clear that the duty of the directors is still owed to the company. In insolvency situations, the interests of the creditors should be taken into account. However, failure to do so is a breach of duty to the company, not the creditor. A creditor cannot sue for breach of that duty; only the company or, should it enter insolvency, its liquidators can.

Finally, the Supreme Court was unanimous in saying the shareholders could not ratify the directors' actions that breached their duties to the company at a time when the company was insolvent or when such actions rendered the company insolvent. This was an important finding because, while the company is financially stable, the shareholders can ratify actions taken by the directors that would otherwise constitute a breach of their fiduciary duties to the company.

British Virgin Islands

In the British Virgin Islands (**BVI**), directors' duties to the company are governed by section 120 of the BVI Business Companies Act, 2004. This section is markedly different from its counterpart in the United Kingdom. In the BVI, the directors have a duty to act in good faith in the company's interests. Unlike the UK, the BVI legislation does not contain a list of stakeholders, such as members and employees, whose interests need to be considered in the discharge of that duty.

In the BVI, the directors' duty to act in good faith in the company's interest is capable of being abrogated where the company falls into one of the below three categories:

When that is the case, the directors can act in the interests of the parent company or only one of the shareholders (usually the shareholder appointing the director), as the case may be. Immediately, this presents difficulties; both where the company has creditors and where it might be insolvent or approaching insolvency. It is not clear how (or even if) the rule in *West Mercia* could apply if the company's directors are acting in the interests of the parent company or only one or some of its shareholders.

The Supreme Court in *Sequana* looked in detail at the rule in *West Mercia* as it has developed as a matter of common law and whether it survived the enactment of the Companies Act, 2006. The Eastern Caribbean Court has not yet given any detailed analysis of the rule in *West Mercia*. In circumstances where the legislation is so different, there is a question mark as to whether it survived the enactment of the BVI Business Companies Act 2004 if it did exist as common law in the BVI.

While the BVI Courts often follow decisions in England and, in particular, those of the United Kingdom Supreme Court, those decisions are not binding. In the specific context of section 120 of the BVI Business Companies Act 2004, it is difficult to reconcile aspects of the *Sequana* judgment with BVI law. It may be tempting to suggest that section 120 of the BVI Business Companies Act 2004 can accommodate a rule requiring directors of BVI companies to take creditors' interests into account in insolvency situations. However, it is hard to square that with the carve-outs in section 120 for subsidiaries and joint ventures. It may very well be that the rule in *West Mercia* applies in the BVI but is qualified for subsidiaries and joint ventures. But can it be the case that the BVI legislature deliberately stripped away common law protection for creditors for those kinds of companies without expressly saying that it was doing so?

It remains to be seen how the BVI Commercial Court will grapple with the *Sequana* decision in the context of the BVI Business Companies Act 2004. The *Sequana* decision is important because it clarifies the duties of directors of companies facing insolvency in the United Kingdom. However, a BVI judgment dealing with the issues will be needed before we can be confident about how the *Sequana* decision will affect the law in that jurisdiction. Many questions remain from a BVI perspective, but it is recommended that directors of BVI companies seek legal advice on their duties under section 120 where the company approaches or finds itself in financial difficulty.

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