McCann FitzGerald

Briefing

Directors' duty to have regard to the interests of creditors: Irish and English law contrasted

This briefing was produced by the Institute of Directors in association with McCann FitzGerald LLP for use in Ireland. McCann FitzGerald LLP is one of Ireland's premier law firms, providing a full range of legal services to many of Ireland's leading businesses. Clients include international organisations, major domestic concerns, emerging Irish companies and clients in the State and semi-State sectors.

In both jurisdictions the general consensus was that where a company is insolvent, the fiduciary duty of its directors to act in the interest of the company (Irish law), or in the way they consider, in good faith, would be most likely to promote the success of the company in the interests of its members as a whole (English law), altered such that directors were required to treat creditors' interests in priority to shareholders' interests. Directors must consider the interests of creditors as a whole, and not just the interests of any individual creditor or class of creditors. The legal obligation on directors' was considered to be broadly similar where a company was close to insolvency.

Position under Irish law

In Ireland the European Union (Preventative Restructuring) Regulations 2022, enacted in July of this year, codified the duty as follows:

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" (that phrase is widely defined and goes beyond balance sheet or cash flow insolvency) must 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 duty imposed on a director is expressly stated to be owed by them to the company (and the company alone) so it is not enforceable by creditors.

2. A new fiduciary duty was added to the then existing 8 fiduciary duties (codified in the Companies Act 2014) so that in addition to the duty at 1 above, directors must have regard to the interests of its creditors where the directors become aware of the company's insolvency. (Unfortunately the test at 1 re inability to pay its debts is not expressly used in the Irish Regulations as the metric for insolvency and the reference to a director becoming aware appears narrower than the belief/reasonable cause to believe test at 1 above; it remains to be seen how an Irish court will reconcile the text). Again the duty is owed to the company alone. The duty is stated to be one of a number of the 9 duties to be based on certain common law rules and equitable principles and to have effect in place of those rules and principles as regards the duties owed to a company by a director.

Position under English law

In England the UK Supreme Court has handed down judgment in October in the case of **BTI 2014 LLC (Appellant) v. Sequana SA and others (Respondents) [2022] UKSC 25**, concerning the duty of directors of an English and Wales incorporated company to consider the interests of the company's creditors.

It was held that whilst directors' duties are owed to the company itself, rather than directly to its shareholders, when the company is insolvent or bordering on insolvency, the duty to promote the success of the company is extended as a matter of common law, such that the interests of the company are understood to include the interests of the company's creditors as a whole as well as those of its shareholders. In that case the duty could apply to the payment of a dividend that otherwise was in compliance with the statutory rules on making distributions (the statutory rules are broadly similar in both jurisdictions).

Accordingly, where the company is insolvent or bordering on insolvency, but it is not an inevitability that it will be subject to an insolvent liquidation or an administration, the directors will need to balance the interests of the company's creditors with the interests of its shareholders. The duty is to consider the interests of the company's creditors as a general body and where an insolvent liquidation or an administration is inevitable, the creditors' interests become paramount. Importantly the Supreme Court decided that a "real risk of insolvency" at some point in the future is not sufficient to trigger the duty to creditors, the prospect of an insolvency might be temporary, so the court favoured a later rather than earlier trigger event (the Court of Appeal had suggested that the duty is triggered where insolvency was probable, a view not shared by the Supreme Court).

Comparison

Whilst the insolvency regimes (and creditor protection reliefs) in each jurisdiction are different, the law in England and Ireland concerning the duty of directors' to have regard to the interest of creditors is broadly similar so that the duty is owed to the company alone and is not enforceable directly by creditors.

In both jurisdictions shareholder and creditor interests may require to be considered by directors in exercising their statutory (primarily) fiduciary duties: in effect there is a sliding scale after the creditor duty is engaged so that as a company moves closer to inevitable insolvency a greater weight will be given to creditor's interests; once insolvency is inevitable, creditors' interests are paramount.

Some differences exist:

Test for insolvency

In this context in England insolvency means balance sheet or cash flow insolvency whereas, as mentioned above, there is a wider definition in the Irish Regulations.

The issue of "*belief*" versus "*knowledge*" in the test for triggering the duty

- In Ireland, the duty is triggered when a director of a company believes, or has reasonable cause to believe, that the company is, or is likely to be, unable to pay its debts (as defined). However, as mentioned above, the Irish Regulations also refer to the directors having a duty to consider creditors' interests where the directors become aware of a company's insolvency so it is not clear whether there is one or two trigger points under Irish law to engage the duty. Given the wording of the Irish Regulations, it can be argued that the duty to consider creditors' interests is wider than (as the UK Supreme Court held in Sequana) a modification of a basic fiduciary duty of directors. In practice any such distinction in Irish law may not be significant as the Irish Regulations simply state that the directors are to have regard to, rather than prioritise, those interests.

- In England the majority of the Supreme Court held that the duty arises when the directors know or ought to know that the company is insolvent or bordering on insolvency, or that an insolvency liquidation or administration is inevitable. (However two of the judges left open the question of whether it is essential that the directors know or ought to know that the company is insolvent or bordering on insolvency.)

Some concluding thoughts

In both jurisdictions directors need to stay informed of the financial position of their company and to have in place warning mechanisms if cash reserves or asset values are eroded. Careful analysis of contingent liabilities is required so that the directors are aware at an early stage whether there is a risk that creditors will or may not get repaid.

Each situation will turn on its facts so that it will not necessarily be evident in all cases when the duty is triggered. In both jurisdictions prudent directors may still struggle to determine if and when the creditor duty has been triggered and may end up exercising as much caution in such circumstances as they would have done (in Ireland) prior to the Irish Regulations (and in England) prior to the Sequana judgment.

Once the duty to creditors is engaged, directors should obtain professional advice as what action (if any) is required and, in particular, whether contemplated transactions (such as payment of dividends) ought to proceed. In some cases the action may well be to initiate liquidation: the Irish Regulations encourage directors to have regard to early warning mechanisms of possible insolvency and assist the company to take steps (for example avail of an examinership process) to survive without going into liquidation.

Directors in both jurisdictions, can, whilst acting reasonably, continue to have regard to "light at the end of the tunnel" in managing a company's response to insolvency risk.

A record of decisions taken and the reasoning behind them should be kept (usually in the minutes of board meetings). Those records will be important if litigation is subsequently brought against the directors in respect of decisions taken by them.

Further information is available from

Michael Murphy
Partner
+ 353 1 611 9142
michael.murphy
@mccannfitzgerald.com

Lisa Smyth
Partner
+ 353 1 607 1730
lisa.smyth
@mccannfitzgerald.com

David O'Dea
Partner
+ 353 1 607 1737
david.odea
@mccannfitzgerald.com

Alternatively, your usual contact in McCann FitzGerald will be happy to help you further.

© McCann FitzGerald LLP and Institute of Directors in Ireland 2022. All rights reserved.

Institute of Directors in Ireland, Europa House, Harcourt Street, Dublin 2
01 411 0010 | info@iodireland.ie | www.iodireland.ie

This document is for general guidance only and should not be regarded as a substitute for professional advice.
Such advice should always be taken before acting on any of the matters discussed.