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DIRECTORS' DUTIES AND THE NEED TO ENHANCE CREDITOR PROTECTION: SECTION 172(3) OF THE UK COMPANIES ACT 2006

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Key words: Company law; Directors' duties; Accountability; and Creditor protection

Abstract

The law requires that directors act in a way they consider in good faith, to promote the success of the company for the benefit of its members. However, under certain circumstances directors are required to consider or act in the interests of creditors. In construing the law, particularly section 172, when the company is in financial distress, section 172(1) is substituted by section 172(3) hence the focus is no longer the members but creditors. This duty is applicable to directors when the company is insolvent, nearing insolvency or in doubtful insolvency. However, the interpretation of this section has attracted a lot of debate because the law is not clear on the actual aspects of application. Even though the duty flows from the traditional fiduciary duty to act in the best interest of the company, courts have been tentative in stating when the duty arises or comes into effect.

Introduction

Before the Companies Act 2006 (CA), directors fiduciary duties were to be performed in good faith in the best interest of the company.[1] This included consideration of creditors' interests during financial difficulties as in *Lonrho v Shell Petroleum.*[2] Lord Diplock mentioned that the exclusivity of shareholders' interests may not be the interests of the company without inclusion of creditors.[3] Lord Buckley stated in *Re Horsley and Weight Ltd*[4] that directors owe an indirect duty to creditors to ensure that the capital of the company is not unlawfully reduced. In *Brady v Brady,*[5] the House of Lords said that directors needed to consider creditors' interest if they were to act in the best interest of the company by not allowing exploitation of company assets.

[1] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[2] [1980] 1 WLR 627
[3] Ibid
[4] [1988] 3 ALL ER 617 (HL)
[5] [1989] 3 BCC 535 (CA)

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These illustrate how the courts established that interests of a company included creditors. This was to inhibit externalisation of costs during financial difficulties especially when a company is relying on creditors' money for projects it could not finance with internal money.[6]

After codification, directors are to act in good faith to promote the success of the company for the benefit of the Members and in the process, they are to consider other issues such as relationships of the company with its suppliers, employees or customers.[7] And in certain circumstances they are to consider the interests of creditors.[8] The purpose for shifting of duty is to protect creditors during financial difficulties yet its implementation is surrounded by uncertainties which expose creditors to unwarranted risk. This study analyses the interpretational challenges that affect creditors in terms of implementation. Certain statements from court decisions such as 'when a company is in doubtful insolvency'[9] have been used to determine the time of effect. Grantham argued that where a company is rapidly approaching insolvency, it is rational for a company to make an investment which is riskier but offers the possibility, although remote, of a bonanza payoff that will prevent insolvency.[10] He further asserts that this rationality for riskier projects derives from the concept of limited liability for shareholders because upon insolvency, their investments would have already been lost and makes sense to use creditors in what may be a fruitless rescue attempt.[11] This shift in duty attempts to prevent companies from externalising costs because sometimes companies embark on ventures which they cannot sustain without relying on creditor funds when a company is in distressed mode.[12] It is argued that this duty regarding creditor protection is ineffective and triggered late. While most literature dwells on the uncertainties in the law, this paper draws on the effect of these uncertainties on creditor protection and how these can be removed to enhance creditor protection. This calls for effective implementation of the law on holding directors accountable for their decisions when a company has gone into insolvent liquidation. The paper firstly focuses on the nature of directors' duties, and secondly, analyses the uncertainties surrounding the duty including the decision in BTI v Sequana, and concludes with the discussion on the proposed framework for creditor protection.

[6] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[7] Section 172(2), Companies Act, 2006
[8] Section 172(3), Companies Act, 2006
[9] Re Horsley & Weight Ltd [1982] 1 Ch 442
[10] Ross Grantham, 'The Judicial Extension of Directors' Duties to Creditors' (1991) JBL, 1, 1
[11] (Ibid)
[12] Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140

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The nature of the duty under section 172 of the CA 2006

The law requires that directors act in a way they consider in good faith, to promote the success of the company for the benefit of its members. [13] However, under certain circumstances directors are required to consider or act in the interests of creditors.[14] In construing the law, particularly section 172, it is imperative to note that when the company is in financial distress, section 172(1) is substituted by section 172(3) hence the focus is no longer the members but creditors.[15] This duty is applicable to directors when the company is insolvent, nearing insolvency or in doubtful insolvency.[16] Nevertheless, the interpretation of this section has attracted a lot of controversy because the law is not clear on the actual aspects of application. It has been argued that even though the duty flows from the traditional fiduciary duty to act in the best interest of the company, courts have been tentative in stating when the duty arises or comes into effect.[17] Keay stated that even after the duty was codified, it is inadequate in terms of principles attached to it hence he submitted that the law may not be fit for purpose for which it was enacted.[18] Two major problems have been identified with this duty; the first being the trigger point and secondly, the meaning of 'considering or to acting in the interest of creditors.' This study attempts to address these two issues that seem to harm creditors.

While this provision is meant to protect creditors, its implementation has been surrounded by uncertainties rendering its purpose problematic and perhaps harmful to the creditors that it should be protecting. When a company is in financial difficulties, directors are required to consider creditors' interests because any reckless behaviour during this time could result in personal liability under the Insolvency Act.[19] For directors to be held liable under wrongful trading, the company has to be in formal insolvency proceedings. Another requirement is that directors knew or ought to have known that the company would not recover from such insolvency and that they did nothing to minimise the risk of loss on creditors.[20] The problem is that while directors would want to avoid personal liability, it is actually difficult to tell exactly when the company gets into distressed mode.[21] The first issue is that directors may

[13] Section 172(1), Companies Act, 2006
[14] Section 172(3), Companies Act, 2006
[15] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[16] Andrew Keay, 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach' (2005) CLJ, 46, 614
[17] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: https://ssrn.com/abstract1662411
[18] Ibid
[19] Section 214, Insolvency Act, 1986
[20] Ibid
[21] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140

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have to be able to identify that the company has gone into financial distress. In the recent ruling by the Supreme Court in BTI 2014 LLC v Sequana SA and others[22]it can be argued that no certainty was offered as to the trigger time yet still leaving the uncertainties to linger around. In this case, it was the first time under which the Supreme Court had to decide whether there were circumstances in which directors had to act in, or at least consider the interests of the company's creditors and whether the duty arose prior to insolvency. The court reaffirmed that under section 172(3) of the CA 2006, that directors are to consider the interests of creditors even though this was not a free-standing duty of its own but arose from the directors' fiduciary duty to the company.[23] The court maintained that the duty remained the directors' duty to act in good faith in the interests of the company and the effect of the rule was to require directors to consider creditors' interests along with those of members. While this may be the case, the problem is that that interests of creditors and those of the members may not always align which creates the challenge as to the enforcement of the duty itself by the directors. If directors are serving two competing interests, it puts them in a position where one will be served better at the expense of the other. Since the UK model of corporate governance is based on the shareholder value which is also echoed in the directors' duties, creditors suffer the consequences of these competing interests and uncertainties. Even though the rule was based on the shift in the financial difficulties of a company, there seem to be an argument whose purpose is to distribute the risk of loss to creditors. The shift of the duty was supposed to give creditors some form of weight or consideration and not to harm them in the process. However, this has been very difficult to achieve bearing in mind that the uncertainties surrounding the shift could mean that potential harm has already occurred even though the court stated that the weight to be given increases as the financial situation deepens.

Lord Briggs, Lord Kitchin and Lord Hodge agreed that where a company is irretrievably insolvent, creditors' interests become paramount to directors when making decisions where there was either imminent insolvency or the probability of insolvent liquidation which the directors knew or ought to have known.[24] They went further to state that even in cases where the where the transaction in question would place the company in insolvency or imminent insolvency. But what exactly does this mean in practice in terms of directors and their duties? There is no simple answer perhaps to this question and even after this decision, the

[22] [2023] 2 All ER 303
[23] Ibid
[24] [2023] 2 All ER 303, p 302

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uncertainties still remain as to when do directors get to know that the time for the shift has come. It was demonstrated in this case that even where there is a real risk of insolvency, is not enough for the directors to shift their interests to creditors but it requires imminent insolvency or the probability of insolvent liquidation. It can be argued that where there is a probability of insolvency there is a real risk of it too. As the duty is owed to the company, case law has indicated a number of trigger points and four of them are discussed. The first is when a company is nearing or approaching insolvency, the second is when a company is in doubtful insolvency, the third is when a company is in actual insolvency and the fourth is when directors know or should know that the company is or is likely to become insolvent.[25]

The first is when a company is in actual insolvency, either cash flow or balance sheet insolvency.[26] This require directors to know for sure that the company is in cash flow[27]or balance sheet insolvency.[28] In *Kinsela v Russell Kinsela Pty Ltd*[29] the court stated that, when a company is financially stable, directors are allowed to have the interests of the shareholders within their duties. However, upon into insolvency, creditors' interests become paramount to directors because the assets of the company belong to creditors during this time. Any decision made by the board to put company assets beyond reach for creditors, is a breach of their fiduciary duty to the company. This decision had so much influence on the English courts and in *Liquidator of West Mercia Safetywear Ltd v Dodd*[30]the court was of the view that when a company is being run for purposes of saving itself not for shareholders during insolvency, it is run for the sole purpose of creditors. Similarly, in *Re Pantone 485 Ltd,* [31] the court stated that when directors perform their duties with interests of creditors, there is no breach of fiduciary duty. This means, if creditors' interests are not considered during financial distress, directors are in breach of their duty to the company.

In the second scenario the duty applies when the company is on the verge of insolvency, nearing insolvency or approaching insolvency. In *Re Horsley & Weight Ltd*[32] it was stated that directors are liable if they made decisions against creditors knowing that the company was in

[25] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[26] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[27] Section 123(1), Insolvency Act, 1986
[28] Section 123(2), Insolvency Act, 1986
[29] [1986] 4 NSWLR 722
[30] [1988] BCLR 250
[31] [2002] BCC 899
[32] [1986] 4 ACLC 215

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doubtful insolvency. In the UK, the court in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*[33] indicated that, for directors to act within their fiduciary duties, they have to contemplate on the impact of their decisions on the capabilities of creditors recovering their money. This puts directors in a position where every decision they make during this time, consideration of its impact need to be weighed against creditors.

The third is said to happen when there is a probability of insolvency or when there is a likelihood of insolvency.[34] In *Facia Footwear Ltd (In Administration) v Hinchliffe*[35] it was shown that cash flow insolvency had been established by directors and they acted in the best interest of creditors as they were fully convinced that the company would survive insolvency. In *Wessely v White*[36] it was held that the managing director had not breached his fiduciary duty because he acted in the interest of everyone including creditors, when he entered into a new contract believing that the advice of a trusted professional was genuine although it turned out to be a mistake. The decision raises a question as to whether going further to seek professional advice is a factor that can be used by directors to illustrate that they did consider creditors' interests. The other issue is whether reliance on such professional advice must be unequivocal considering it is given by a professional. All these questions are difficult to answer as the law does not address them. However, while directors could be free from liability after relying on professional advice, perhaps it could help creditors if, directors could show that relying on such advice was indeed in the best interest of creditors, and that it was independent, free from any influence. This could help in holding the third party liable if they give advice susceptible to misrepresentation in contract law. In such a scenario, the company can sue advisor and the proceeds is to be given to creditors. The idea is for creditors to have recourse within the law protecting them from loss resulting from actions of other people. Even though there has been a consensus on the duty arising when a company is nearing insolvency or on the verge of insolvency or almost insolvent, or in actual insolvency, there seems to be continuous uncertainties on what time exactly the duty is to arise. While these uncertainties are founded on inadequacies of the law in theory,[37] case law has equally not been able to address this question.

[33] [2002] EWHC 2748 (Ch)
[34] Rosemary Teele Langford and Ian Ramsay, 'The "Creditors' Interests Duty": When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[35] [1988] BCLC 218
[36] [2018] EWCA 1499 (Ch)
[37] Donna McKenzie-Skene, 'Directors' Duty to Creditors of a Financially Distressed Company: A Perspective from Across the Pond' (2007) JBTL, 1, 499

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The fourth scenario is when directors know or should know that the company is or is likely to become insolvent. In *BTI 2014 LLC v Sequana SA*[38] the court indicated that anything short of insolvency cannot trigger the duty, as such would not be part of present law, but the duty arises when directors know or should know that a company is or is likely to be insolvent. This requires a company to be in actual insolvency or on the verge of insolvency and it does require that directors should know, or the company must be in a position where directors should have known that insolvency is not only probable but inevitable. Perhaps it means that directors need to know for sure that the company might go into insolvency. However, what about the decisions made when directors think there is no risk of insolvency, yet the company ends up insolvent? This could mean that as long as directors are not certain about insolvency, they have no obligation to consider creditors' interests, or until the company gets into a position where it was inevitable for directors to know that the company was in a risk of insolvency. This could confirm how creditors are left unprotected until the financial position has changed. This is perilous because sometimes creditors might not recover everything even the secured creditors as security does not guarantee removal of risk. This duty attaches to directors the moment they know or are likely to know that the company can no longer pay for debts as it falls due not as a matter of choice.[39] Many have argued to the difficulties of establishing exactly when the company has gone into difficulties despite the guidance of case law as the courts have surely dealt with each case differently. Keay argues that the theoretical reason for the shift of the duty is because in the vicinity of insolvency, the residue risk bearers are no longer shareholders but creditors whose rights are equity-like.[40] While this problem has been identified on the part of directors as a practical issue, it represents a legal problem detrimental to creditors as well as to the intention of the law. It has been established that doing business with an incorporated company is a known risk for creditors. Lord Justice Richards in BTI stated that the purpose of incorporating companies is for businesses to be carried on for shareholders who want to make profits, and this happens through risk taking ventures. This is what shareholders want and for them to make more profits, they have to take certain risks and it is up to creditors to protect themselves using mechanisms like security because, considering creditors' interests when there is no likelihood of insolvency, will hinder risk taken by directors and economic benefits of doing business.[41]

[38] [2019] EWCA Civ. 112
[39] James Morgan, 'Directors' duties in the insolvency context' (2015) II, 28, 1
[40] Andrew Keay, 'Directors' 'Duties and Creditors' Interests' (2014) LQR,130, 443; Andrew Keay, 'Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR 24, 140
[41] BTI 2014 LLC v Sequana SA [2019] EWCA Civ. 112 p. 202

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This implies that until the company is in a financially dangerous position, creditors' interests are not to be considered by directors. It is suggested that this duty be considered while the company is financially stable to protect both the company and creditors. This arises from the argument that the best interests of the company could include those of creditors as established in *Brady v Brady.*[42] If the company has corporate finance, it helps both the company and shareholders but at the same time, the providers of that finance need protection from risk. Also under section 172(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 the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company'.[43] Based on this section, creditors as suppliers of corporate finance can as well be given consideration for purposes of maintaining a company's reputation with creditors and also fostering corporate relationships.

What does the duty to consider creditors interests mean?

The second problem is regarding the meaning of considering creditors' interests or acting in the interests of creditors.[44] The law is not clear on what directors are to be doing. There are three issues associated with this deficiency. The first issue is if directors while performing their duty under section 172(1) need to balance the interests of shareholders alongside creditors' interests.[45] The second issue is whether during financial difficulties, directors have to prioritise the interests of the company alongside creditors' interests. The third issue is whether they have to prioritise the interests of creditors only when a company is financially struggling. [46] There is enough evidence to indicate in the UK, creditors' interests need to be paramount to directors during financial distress however, the meaning of what this entails of directors' behaviour is left to be decided according to facts of each case.[47] There is need to understand what directors

[42] [1988] 2 All ER 617
[43] Section 172(1), Companies Act, 2006
[44] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[45] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385
[46] Andrew Keay, 'The Shifting of Directors' Duties in the Vicinity of Insolvency' (2015) IIR, 24, 140
[47] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385

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are to be doing during this time to render the law effective. To begin with the duty under section 172(1) has been argued not to be fit for the purpose it was enacted because it does not solve the problems directors had prior to the enactment.[48] The duty enshrined in the statute is a reflection of the enlightened principle of the shareholder value model in the UK.[49] It has been said that section 172(1) is enshrined to promote the principle of enlightened shareholder value.[50] The section indicate that even though the duties are owed to the company, the ultimate benefit is for members. Does this suggest that directors' duties can eventually be extended to shareholders as directors have them as the ultimate group to which they owe their duties? The answer could be found from the interpretation of law and how the courts have applied it. On one hand within the law, directors' duties are owed to the company and not shareholders as stipulated under section 170.[51] On the other hand under section 172(1), the duties are to be performed with the ultimate benefit of the members who actually have influence and control over directors. This has promoted the shareholder primacy model of governing the firm to which directors seem to have in mind when performing their duties. This could mean that the uncertainties in the law are still present as under common law. Lynch argued that the law only changed in form and not in substance as it only restated the pre-existing duty and this is why Lynch called it 'a law dressed in nothing but air waiting for someone to point out the reality.'[52] Lynch went further to argue that although the purpose for codification was to clarify the challenges faced by directors and to make the law more accessible, the law did not achieve this purpose in terms of application because it brings nothing new to the table.[53] *Lord Glennie in Re West Coast Capital (LIOS) Ltd*[54] stated that the section in the Companies Act brings nothing novel to the table except acknowledge of the pre-existing law. This view was also followed in *Cobden Investments Ltd v RWM Langport Ltd*[55] when Warren J. stated that '…..perhaps the old-fashioned phrase acting 'bona fide in the best interest of the company' is reflected in the statutory words acting 'in good faith in a way most likely to promote the success of the company for the benefit of its members as a whole.'[56]

[48] Andrew Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (2010) University of Leeds School of Law, Working Paper, Accessed on 13/02/2017 from: SSRN: https://ssrn.com/abstract=1662411
[49] Jin Zhu Yang, 'The Role of Shareholders in Enforcing Directors Duties: A Comparative Study of UK and China: Part 1' (2006) ICCLR, 17, 318
[50] Alan Digman and John Lowry, *Company Law* (8th ed. Oxford University Press, 2014) 180
[51] Section 170, Companies Act, 2006
[52] Elaine Lynch, 'Section 172: A Ground-breaking Reform of Director's Duties, or the Emperor's New Clothes?' (2012) CL, 33, 196
[53] Ibid
[54] [2008] CSOH 72
[55] [2008] EWHC 2810
[56] Ibid, p.52

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The ineffectiveness of this duty has a negative impact on creditors. There is a dearth of literature in terms of protection of creditors who rely on the covenants for security. Selling off the security or collateral does not elevate the risk although to an extent it can mitigate against a risk but that is not the ultimate goal for creditors. While corporate law focuses on the obligations of directors and insolvency law focuses on the recovery of funds by creditors,[57] there is no practical mechanism on the protection of creditors before the company falls into insolvency thereby exposing creditors to risk. The implication is the challenge in knowing what exactly directors ought to be doing once the shift has been triggered. In obiter, Lord Richards in *BTI 2014 LLC v Sequana SA*[58] indicated that the integration of the duty under section 172(1) with creditors is problematic, if the interests of creditors are not taken as paramount.[59] This is owing to the conflict that could exist between the interests of creditors and what is meant by the success of the company. The duty once triggered could only be effective if creditors are given paramountcy in merit with the decision in *Kinsela v Russell Kinsela Pty Ltd* where it was stated that in a practical sense the assets of the company become assets of creditors under the management of directors.

While this seems to be a settled argument in this study, the ingredients of the duty itself remain unresolved. Keay in his article[60] discusses a lot of issues but three of them have been selected with keen interest based on the significance they have in relation to the objective of this paper and have been used to construct what has been referred to, as the shifting-duty framework in this research.[61] Note that sometimes there would be no new contracts under negotiations when a company is financially struggling but it is argued that more likely than not new projects will be implemented in order to try and save the company. The authority of directors when negotiating contracts is guided by statute, articles of association, by-laws, and sometimes board decisions or minutes. This is because during this time, there is personal liability that could be imposed and sometimes they want to eliminate that risk by entering formal procedures like administration or other restructuring procedures in the statute. However, they are also guided

[57]Marjan Marandi Parkinson, 'Corporate Governance During Financial Distress – An Empirical Analysis' (2016) IJLM, 58, 486
[58][2019] EWCA Civ 112
[59] Ibid p.99
[60]Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214
[61]Designed by the researcher to illustrate the importance of these issues in determining what it means to consider creditors interests based on Keay's Paper entitled: Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214

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by the duty of loyalty which requires them to act in the best interest of the company.[62] While this is true, during financial difficulties they will be under the duty to consider creditors' interests and it is within this time that their actions are considered. Once presented with an opportunity of a new contract, directors could take the following into consideration; the first issue is the size and nature of the company in question, the second is the nature of the contract under consideration, and the third is the level of risk involved.[63]

This is important because it helps to assess product and market risk in the industry. And certainly, the most important is that directors would not want to enter into a contract with a company that is also in financial distress because it would be reckless. When assessing the nature of the business, great attention is to be given to the obligations and terms of the contract and how these will impact the contract. This is because during financial difficulties, directors need to consider the impact of their decisions on creditors as was held in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd.*[64] This is to assess the impact the contract will have on creditors as a class and the possibilities of recovering their money. The problem this could present is the fact that creditors are different however, the decision could perhaps consider them as a class.

The second issue is the nature of the deal or the contract to be assessed if it can bring in money within a reasonable time to pay off creditors. This helps to evaluate whether the nature of the contract can make money on a short term or a long-term basis. This is because creditors want to be assured that they will be paid, and time is of essence especially with the accumulation of interest. The third issue is the level of risk. This is assessed first in connection to the actual extent of the financial distress, and to the reality of how things would be if the deal is not entered into. Directors will have to assess the risk factors such as impact of the contract if they enter into it and it fails to produce the money expected, the risk likely to be caused if such an opportunity of the contract is missed and also the implication of the risk on creditors. Is it a low risk project to creditors such that if implemented, there would be no substantial risk of loss and if so, what amounts to substantial risk considering the amount of debt in total? While this may seem easy in theory, in practice it is difficult because where trade creditors are involved,

[62] David Milman, 'Company Directors: Maintaining the Balance Between Protecting Managerial Rights and Regulating Exposure to Liability in UK Law' (2016) CL, 390, 1
[63] Andrew Keay, 'Directors Negotiating and Contracting in the Wake of their Companies' Financial Distress' (2015) JSCN, 1, 214
[64] [2002] EWHC 2748 (Ch)

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this could be more difficult with both secured and unsecured creditors because their interests are different and directors need to be careful not to treat any creditor differently.

Special attention needs to be paid to the fact that directors may be committing wrongful trading in trying to save the company. This happened in the fall of Carillion and in the case of *Grant v Ralls.*[65] Directors on one hand have shareholders and their interests of wanting more profits during which they want the company to implement risky projects as stated by Lord Richards in *BTI 2014 LLC v Sequana SA.*[66] On the other hand directors have creditors' interests and these involve full payment, or at least reduced risk which means, they want the company to avoid risky projects because they might lose their money. What directors would want to do is to balance these interests however, this is difficult for directors henceforth, Keay stated that to substitute this problem, directors are more likely to adopt the entity maximisation approach in order to serve the interests of the company which seemingly might benefit both shareholders and creditors.[67] The entity maximisation approach will endeavour to increase the market value of the company[68] but this contemplates the interests of both shareholders and creditors as they have claims on the company.

The undisputed argument is that creditors' interests still need to be considered even during the entity maximisation approach because whatever the company ends up with, creditors will have the first claim. It can be argued that if during this time, directors discontinued to consider shareholders' interests and concentrate on creditors, there would be no opportunity for the balancing problem. This is because legally directors ought to have as a matter of priority creditors' interests only until the company is financially stable.[69] Two issues have been added namely probability of fruitfulness of the deal and contingency plan in case it fails. Directors, after having assessed the three issues discussed, ought to have an indication of the probability for the contract to work. Most desirable this would also require directors to deal in good faith even if they do consult an expert. It is not enough to show that this was considered, but it must be supported that consideration was given with supporting evidence and that the decision taken was in the best interest of creditors. There is also great need for a plan workable for creditors

[65] [2016] EWHC 243 (Ch)
[66] [2019] EWCA Civ. 112
[67] Ibid
[68] Michael Jensen, 'Value Maximisation, Stakeholder Theory, and the Corporate Objective Function' (2001) EFM, 7, 297
[69] Rosemary Teele Langford and Ian Ramsay, 'The Creditors' Interests duty: When Does it Arise and What Does it Require?' (2019) LQR, 135, 385

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in case the deal fails to yield any money. This contingency plan could include corporate rescue measures such as restructuring, administration, formal insolvency so that creditors can at least be paid but arguably this must be done in good timing. This is where skill and judgement come into effect for directors so that they do not injure the company, and in return creditors. These constructs must be evaluated for the benefit of creditors only because during this time, creditors' interests supersede the shareholders, and it is creditors' money which is used as external finance for any new deals or riskier projects. This was illustrated in the case of Grant v Ralls where fresh debt was acquired when the company was struggling which eventually was not paid back as the court found that directors were not liable for wrongful trading.

The implementation of the framework proposes minimum steps to be adopted initially by directors. This is because each case is different, but these steps can be assessed before extending the scope of the duty to other issues which could be of importance depending on the circumstances of the distressed mode. So once all the five constructs have been evaluated for the benefit of creditors, it can be argued that creditors' interests were considered not only based on having them in mind but implementing the kind of projects that reduce the risk and also to ensure that during this time, creditors are a priority, and shareholders have nothing to do with these decisions.

What amounts to interests of the company is vital because it helps to indicate what must be done and whose interests must be taken care of? Although at common law this was regarded as the best interest of the company, this entails using a subjective test to establish what was in the best interest of the company and at what stage. The subjective test was formulated in *Re Smith v Fawcett Ltd*[70] and it was reemphasised by the Charterbridge test (though objectively) in the case of *Charterbridge Corporation Ltd v Lloyds Bank Ltd.*[71] The Charterbridge test requires an examination of the individual director concerned if he reasonably believe that what he was doing was in the best interest of the company, put in the same prevailing circumstances as existed before.[72] The court in *Hellard v Carvalho*[73] stated that: section 172 codifies the pre-existing common law duty notwithstanding the difference in the wording. Having established that directors have to act in the interest of the company to promote the success of the company, does it mean any actions taken without the interest of the company is breaching the duty? If

[70] [1942] Ch 304
[71] [1970] Ch. 62, 74
[72] Ibid
[73] [2013] EWHC 2876 (Ch) 2014 BCC 337 at 88

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the answer is affirmative, then the duty under section 172(1) requiring directors to consider the interests of the company with the ultimate benefit of the members is simply stating that the duties are owed to the members and not to the company. In the case of *Madoff Securities International Ltd (In Liquidation) v Raven*[74] where Popplewell J stated that: '[W]here a director fails to address his mind to the question whether a transaction is in the interests of the company, he is not thereby, and without more, liable for the consequences of the transaction. In such circumstances the Court will ask whether an honest and intelligent man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transaction was for the benefit of the company: If so, the director will be treated as if that was his state of mind.'[75]

However, it must be noted that in *Hellard v Carvalho*[76] the court emphasised that the subjective test of the director acting in the interest of the company, is subject to directors considering the interests of creditors at the time. Randall J stated that, the interests of creditors must be 'paramount' when considered by directors exercising their discretion.[77]

The law states that while directors are performing their duties for the success of the company, they ought to have regard to "the need to foster the company's business relationships with suppliers, customers and others,"[78] and also "the desirability of the company maintaining a reputation for high standards of business conduct."[79] The basis for this argument is the importance of the relationship between the company and its creditors owing to the fact that external finance is involved which the company is using for its projects. This money and any associated interest must be paid back to creditors and a good relationship is potentially built from the company having a good reputation in honouring its obligations towards the creditor. This creates lasting corporate relationship and the creditor will be willing to lend to such a company because of its good credit record in terms of its past obligations. The implication of this decision is that if directors want to act in the interests of the company, a good relationship with creditors is also in the interests of the company hence, ensuring that this relationship is fostered, would benefit both the company and the shareholders ultimately.

[74] [2013] EWHC 3147
[75] Ibid
[76] [2013] EWHC 2876 (Ch) 2014 BCC 337 at 88
[77] Rosemary Teele Langford & Ian M. Ramsay, 'Directors' Duty to Act in the Interests of the Company – Subjective or Objective?' (2015) JBL, 2, 173
[78] Section 172(1)(c), companies Act, 2006
[79] Section 172(1)(e), companies Act, 2006

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Conclusion

The duty shows that directors need not take creditors' interests into consideration, except in matters of actual insolvency, which is detrimental to creditors because it is activated late. While others have praised this decision as settling the problem of the effective time, it can be submitted that the problem of determining the point of insolvency still represents uncertainties as to the effective time. It is submitted that this duty be amended in order to ascertain when it is to take effect. The framework if well implemented as the minimum steps to be taken by directors would help towards creditor protection in ensuring that directors do actually take into consideration their interests when a company is financially troubled.

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