BTI v Sequana SA & Implications of Keepwell Deeds under Hong Kong's Insolvency Regime

Explore the implications of directors' duties and keepwell deeds in Hong Kong's evolving insolvency framework

A few years on, the UK Supreme Court's landmark judgment in BTI 2014 LLC v Sequana S.A. [2022] UKSC 25, remains a loud reminder that raised critical questions about the scope of directors' duties when a company faces potential insolvency. The ruling clarified when directors must prioritize creditors' interests above shareholders' interests—a principle commonly referred to as the "Creditor Duty." The judgment also examined the conditions under which this duty is triggered and its application to otherwise lawful corporate actions, such as dividend payments.

Although UK Supreme Court decisions are not binding on Hong Kong courts, they are highly persuasive and closely studied. This decision is likely to influence how Hong Kong courts interpret directors' fiduciary duties in insolvency situations, given the jurisdiction's reliance on common law principles.

The Facts of the Case

The case involved AWA, a company that declared and paid a €135 million dividend to its sole shareholder, Sequana. At the time of payment, AWA was solvent by both balance sheet and cash flow tests. However, it had long term contingent liabilities that could crystallize in the future and lead to insolvency. Nine years later, AWA entered insolvent administration. BTI, as the assignee of AWA's claims, argued that the directors breached their duty to consider creditors' interests when they authorized the dividend and sought recovery of the distributed amount.

Key Findings of the Supreme Court

The UK Supreme Court addressed four important issues relating to Creditor Duty.

First, the Court confirmed the existence of a common law Creditor Duty. Directors owe fiduciary duties to act in good faith in the company's interests, but when insolvency becomes a concern, the company's interests are increasingly aligned with those of its creditors. Directors, as “custodians of the conscience of the company”, must ensure that creditors’ rights are respected under these circumstances.

Second, the Court clarified the content of the Creditor Duty. Directors must consider creditors’ interests, give them appropriate weight, and balance them against shareholders’ interests where there is a conflict. While directors are not required to prioritize creditors’ interests immediately upon financial distress, the weight accorded to creditors’ interests increases as the company’s financial situation worsens.

Third, the Court addressed the question of when the Creditor Duty is triggered. It held that the duty arises when a company is insolvent. A mere real risk of insolvency is insufficient. While the Court suggested in obiter dictum (such statements are not binding) that the duty might also arise when insolvency is imminent or when an insolvent liquidation or administration is probable and directors ought to know this. Even where a company is insolvent, the creditor duty does not compel a director to treat the creditors’ interest as paramount. It is only where an insolvent liquidation or administration is inevitable, the creditors’ interests become paramount as the shareholders cease to retain any valuable interest in the company.

Finally, the Court considered whether the Creditor Duty applies to otherwise lawful dividends. It held that the duty could apply. For example, directors cannot lawfully distribute dividends if doing so would render the company cash flow insolvent, even if it satisfies the balance sheet test of solvency. However, in this case, BTI failed to establish that AWA’s insolvency was imminent or probable at the time of the dividend payment, and thus the Creditor Duty was not engaged.

The Role of Keepwell Deeds in Protecting Creditors

The BTI v Sequana SA decision underscores the challenges creditors face in recovering payments based on breaches of Creditor Duty, particularly when insolvency is not imminent or clearly foreseeable. This highlights the importance of contractual mechanisms like keepwell deeds in providing additional protection for creditors, especially in the context of cross-border bond issuances.

A keepwell deed is a credit assurance typically issued by a PRC parent company to support the solvency and liquidity of its foreign subsidiaries. It is a contractual obligation that reassures bondholders that the subsidiary will remain financially stable and meet its obligations. Keepwell deeds thus play a critical role in managing financial risks and enhancing investor confidence.

Enforceability of Keepwell Deeds and Exclusive Jurisdiction Clauses

The enforceability of keepwell deeds often hinges on the inclusion of exclusive jurisdiction clauses. This issue was examined in Nuoxi Capital Ltd v Peking University Founder Group Co Ltd [2021] HKCFI 3817. In this case, the Hong Kong court upheld an exclusive jurisdiction clause in favor of Hong Kong, even though the keepwell provider was undergoing insolvency proceedings in Mainland China. The court distinguished between disputes requiring adjudication of contractual obligations under the keepwell deed and claims seeking direct enforcement of Mainland insolvency proceedings. While the former fell squarely within Hong Kong’s jurisdiction, the court emphasized the importance of coordinating with Mainland courts in managing cross-border insolvencies.

In a similar case, Citicorp International Limited v Tsinghua Unigroup Co., Ltd. [2022] HKCFI 1558, the Hong Kong court reiterated its willingness to respect exclusive jurisdiction clauses and its expertise in resolving English-law-governed disputes. This decision reinforced Hong Kong’s role as a preferred forum for handling disputes involving keepwell deeds, even in cross-border insolvency scenarios.

These cases have set important precedents for seamless cooperation between Hong Kong and Mainland courts, particularly in disputes involving complex financial instruments like keepwell deeds.

Reciprocal Recognition and Enforcement of Judgments

The enforceability of keepwell deeds has been further strengthened by the evolving framework for reciprocal recognition of judgments between Hong Kong and Mainland China.

As of January 29, 2024, the Mainland Judgments in Civil and Commercial Matters (Reciprocal Enforcement) Ordinance (Cap. 645) has come into effect, making Hong Kong the only jurisdiction globally to establish a comprehensive reciprocal enforcement system with Mainland China. This ordinance allows Hong Kong courts to register and enforce civil and commercial judgments issued by Mainland courts, and vice versa. This mechanism simplifies the enforcement process for cross-border judgments and expands the scope of enforceable judgments to include both monetary and non-monetary awards.

Prior to this, in May 2021, the Supreme People's Court signed a memorandum with the Hong Kong Special Administrative Region government regarding the mutual recognition and assistance in bankruptcy proceedings. This memorandum established a cooperative mechanism for recognizing insolvency procedures. Under this mechanism, Hong Kong liquidators can apply for recognition of insolvency proceedings conducted in Hong Kong from designated Mainland pilot courts, while Mainland bankruptcy administrators can seek recognition in Hong Kong. This framework facilitates the resolution of cross-border insolvency disputes and provides a more efficient legal protection foundation for creditors in both regions.

Implications for Directors of Companies

The BTI v Sequana SA decision serves as a reminder that directors must carefully assess their duties when their company faces financial distress. Directors should actively monitor the company’s financial position and ensure they are fully informed of any risks that could lead to insolvency. This requires consulting professional legal and financial advisers to evaluate the company’s financial health and potential restructuring options.

Directors must also be cautious about making decisions, such as paying dividends, that could exacerbate financial difficulties. Maintaining detailed records of board discussions and decisions is crucial, as this demonstrates compliance with fiduciary duties and provides evidence of directors’ good faith actions.

Keepwell deeds can provide directors with an additional layer of protection by ensuring the company’s liquidity and solvency. By adhering to the obligations set out in these deeds, directors can manage financial risks more effectively and avoid potential breaches of Creditor Duty.

Conclusion

The UK Supreme Court’s ruling in BTI v Sequana SA offers important insights into the scope of directors’ fiduciary duties to creditors, particularly in the context of insolvency. The case underscores the need for directors to carefully assess creditors’ interests when financial distress arises and highlights the challenges of determining when the Creditor Duty is triggered.

In Hong Kong, the legal framework for the enforcement of keepwell deeds and the recognition of cross-border insolvency proceedings continues to evolve. Since January 29, 2024, the Mainland Judgments in Civil and Commercial Matters (Reciprocal Enforcement) Ordinance (Cap. 645) has come into effect, further simplifying the enforcement procedures for cross-border judgments and enhancing the efficiency of creditors in executing judgments across the two jurisdictions.

For directors, the judgment emphasizes the importance of proactive risk management, diligent decision-making, and seeking professional advice in times of financial uncertainty. For creditors, the effect of keepwell deeds should be considered under the clarified Creditor Duty and the new reciprocal enforcement framework for safeguarding their interests and ensuring enforceability in complex cross-border transactions.

For inquiries about how JML can assist with navigating directors’ duties, cross-border insolvency issues, or structuring and enforcement of keepwell deeds, please contact us or scan the QR code below to learn more about our tailored legal solutions and services.