

Challenging lawful dividend payment as a transaction defrauding creditors and for breach of directors' duties (BTI 2014 LLC v Sequana SA and others; BAT Industries plc v Sequana SA and another)

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Restructuring & Insolvency analysis: Ciaran Keller, barrister at Essex Court Chambers, discusses the practical implications of the judgment in *BTI 2014 LLC v Sequana SA and others*, *BAT Industries plc v Sequana SA and another*, which clarifies, with respect to a lawful dividend payment, when remedial relief under section 423 of the Insolvency Act 1986 (IA 1986) may be granted and when directors' duties to have regard to the interests of creditors (the creditors' interests duty) may apply.

BTI 2014 LLC v Sequana SA and others; BAT Industries plc v Sequana SA and another [\[2019\] EWCA Civ 112](#), [\[2019\] All ER \(D\) 36 \(Feb\)](#)

What are the practical implications of the decision?

The Court of Appeal confirmed that a dividend which is neither unlawful nor paid in breach of fiduciary duty is capable of being challenged as a transaction defrauding creditors under [IA 1986, s 423](#).

The Court of Appeal also considered when the creditors' interests duty is engaged. It stated that the answer to that question has 'very significant practical consequences for the conduct of business'. Having reviewed the English and Commonwealth authorities, it clarified that the creditors' interests duty may be engaged prior to actual insolvency and, in a new statement of the test, held that the duty is engaged from the point at which directors know or should know that the company is or is likely (in the sense of probable) to become insolvent.

The Court of Appeal declined to determine the 'important issue' of the content of the creditors' interests duty once engaged, and in particular, whether creditors' interests are then paramount or are merely to be taken into account. However, it commented that, if the duty was engaged from the point at which directors know or should know that the company is or is likely to become insolvent, it was hard to see that creditors' interests could be anything other than paramount.

What was the background?

On 11 July 2016, Rose J gave judgment on issues of liability in proceedings brought by British American Tobacco (BAT) against a French listed conglomerate (Sequana), and by BAT's subsidiary (BTI) against Sequana's wholly owned subsidiary (AWA), its directors and Sequana, in relation to dividends paid in circumstances where AWA was exposed to substantial claims in connection with environmental liabilities in the US.

Broadly, AWA was exposed to very substantial, long-term environmental liabilities in the US in relation to the clean-up of rivers polluted by discharges from paper mills, including the Fox River in Wisconsin and the Kalamazoo River in Michigan. BAT was also exposed to these liabilities but had the benefit of an indemnity from AWA.

The claims brought by BAT and BTI concerned dividends paid in 2008 and 2009 by AWA to its parent, Sequana, which were applied to discharge an inter-company debt owed by Sequana to AWA. As a result of the dividends, the assets available to AWA to meet its environmental liabilities were very substantially diminished.

BTI claimed that the dividends were unlawful and were paid in breach of the creditors' interests duty where AWA was at real risk of insolvency. BAT claimed that the dividends were transactions defrauding creditors within the meaning of [IA 1986, s 423](#).

The judge dismissed BTI's claim, but BAT succeeded on its claim under [IA 1986, s 423](#) in respect of the 2009 dividend, finding that the 2009 dividend was a transaction at an undervalue paid with the purpose of putting assets beyond the reach of creditors or otherwise prejudicing their interests for the purposes of [IA 1986, s 423](#).

Following a further two-day hearing in January 2017, the judge ordered Sequana to pay €138m to BTI, plus further sums up to a ceiling of the level of the 2009 dividend plus interest.

There were appeals against the judge's decision in both claims:

- Sequana appealed against the judge's decision that the 2009 dividend was paid contrary to [IA 1986, s 423](#), contending that:
 - a dividend was not a transaction at an undervalue
 - the judge conflated the purposes of AWA and Sequana and the payment of the dividend and subsequent sale of AWA, and
 - the remedy granted should have been limited to AWA's present obligations following an agreement entered into with BAT, BTI and others after the BAT claim was issued (the Funding Agreement) or the difference between the amount of the 2009 dividend and the amount of an alternative dividend that could lawfully and would in fact have been paid
- BTI appealed against the dismissal of its claims that the 2009 dividend was paid in breach of the directors' fiduciary duties, contending that the judge should have found that the creditors' interests duty was engaged when the directors knew or should have known that there was a real, as opposed to a remote, risk of insolvency

What did the Court of Appeal decide?

The Court of Appeal dismissed Sequana's appeal on the BAT claim (save in respect of a point on the date from which interest at a particular rate should run), holding that:

- [IA 1986, s 423](#) was capable of applying to a lawful dividend paid in accordance with [Part 23](#) of the Companies Act 2006 ([CA 2006](#)). There was no warrant for reading [IA 1986, s 423](#) as qualified by [CA 2006, Pt 23](#)
- although a dividend is not a 'gift' (because it is commercially and legally a return on the shareholder's investment) it is a transaction for no consideration. It involves the payment of funds beneficially owned by the company to its shareholders for which the company receives no consideration
- the language of [IA 1986, s 423](#) does not preclude its application to the payment of a dividend and there was no policy reason why it should be confined to gifts and bilateral transactions. It would be surprising if the payment of a dividend in specie fell within [IA 1986, s 423](#) (which Sequana accepted it did) but a cash dividend did not. The payment of a dividend was within the scope of the section even if it could not be said to involve an agreement or arrangement between the company and the shareholders, although on the facts, the 2009 dividend was part of an arrangement between AWA and Sequana in any event
- the judge made clear findings of fact that AWA had the statutory purpose in paying the 2009 dividend
- on the question of relief, Sequana had not advanced a case or adduced any evidence that some lesser dividend would have been paid. Further, given the judge's unchallenged findings that the Funding Agreement was in part a response to the insolvency of AWA to which the 2009 dividend contributed and AWA's liability in respect of the clean-up costs would have been greater if the context had been different, it was for the judge to fashion the remedy that in her discretion she considered would best restore the position to what it would have been if the 2009 dividend had not been paid and best protect the interests of victims

The Court of Appeal dismissed BTI's appeal, holding that:

- the creditors' interests duty may apply to the payment of a lawful dividend (ie paid in accordance with the requirements of [CA 2006, Pt 23](#))

- the creditors' interests duty may be engaged short of actual insolvency
- the imminence of insolvency in temporal terms is not determinative as to whether the creditors' interests duty is engaged
- there was no binding authority on the question of when short of actual insolvency, the creditors' interests duty is engaged, the answer to which is 'a difficult amalgam of principle, policy, precedent and pragmatism'
- the creditors' interests duty is not engaged when (as BTI contended) the directors knew or should have known that there was a real, as opposed to a remote, risk of insolvency, but rather when the directors knew or should have known that the company was or was likely (in the sense of probable) to become insolvent

The Court of Appeal declined to determine the content of creditors' interests duty once engaged, but expressed the view that if it was correct in relation to the trigger test, it was hard to see that creditors' interests could be anything other than paramount.

This may not be the last word on either topic. It remains to be seen whether permission to appeal will be sought from or granted by the Supreme Court.

Interviewed by Susan Ghaiwal.

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