Interests of creditors and remedial discretion (BAT Industries plc v Sequana SA)

08/03/2017

Restructuring & Insolvency analysis: Can the legality of a dividend be challenged on the grounds that it constitutes a transaction defrauding existing or future creditors, contrary to section 423 of the Insolvency Act 1986 (IA 1986)? Ciaran Keller, barrister at Essex Court Chambers, and Andrew Thompson QC, barrister at Erskine Chambers, assess and examine the practical implications of the judgment in BAT Industries plc v Sequana SA.

Original news

BTI 2014 LLC v Sequana SA and others; BAT Industries plc v Sequana SA and another [2017] EWHC 211 (Ch), [2017] All ER (D) 176 (Feb)

The Chancery Division ruled on consequential matters following its main judgment (liability judgment) on claims brought against Sequana SA and others, challenging dividend payments (BTI 2014 LLC v Sequana SA and others; BAT Industries plc v Sequana SA and another [2016] EWHC 1686 (Ch), [2016] All ER (D) 96 (Jul)). In respect of the second claim, the court held that, in circumstances where the claimant (BAT) had succeeded in part on its claim, under IA 1986, s 423 (transfers defrauding creditors), it would be wrong to treat an agreement, entered into following the main judgment, as a change of circumstance, which militated against the grant of any relief to BAT, under IA 1986, s 423. Accordingly, BAT was granted relief, under IA 1986, s 423.

What are the practical implications that those advising can take away from this decision?

This decision emphasises that the courts have a very broad discretion as to the appropriate remedy to be granted in response to a transaction that contravenes IA 1986, s 423. The overriding purpose of IA 1986, s 423 is to recover assets for the victims of the transaction so as to protect their interests. It is only in an exceptional case that no relief will be granted. Relief will be carefully tailored to the justice of the particular case. A factor to be taken into account is the state of mind or other action on the part of the transferee. The court will not be impeded from reaching a just result by the fact that perfect restoration is impossible, or by hard and fast rules.

There is no justification for the court stepping in to rescue the transferor and transferee from the consequences of a transaction that contravenes IA 1986, s 423 by investigating hypothetical alternative transactions that they could legitimately have entered into.

The court ordered Sequana to pay over $138m to BTI and found Sequana liable to make further payments in very substantial further sums if and when the victims of the IA 1986, s 423 transaction are required to pay further clean-up costs. In circumstances where the court had (in the liability judgment) found that the dividend paid in contravention of IA 1986, s 423 was neither unlawful nor paid in breach of fiduciary duty, this decision highlights that IA 1986, s 423 is a powerful tool in the armoury of those seeking relief in respect of transactions at an undervalue which have prejudiced creditors' interests.

What was the background to this case?

On 11 July 2016, Mrs Justice Rose gave judgment on the issues of liability in the proceedings brought by BAT Industries plc and its corporate vehicle, BTI 2014 LLC, against the French listed conglomerate, Sequana SA, and the former directors of Sequana's former wholly owned subsidiary, Windward Prospects Ltd (AWA).

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. The costs of clean-up of the Fox River have recently been estimated by the US Department of Justice as being likely to exceed $1bn. 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.

BAT/BTI claimed that the dividends were unlawful, were paid in breach of the directors' duties to consider creditors' interests where AWA was at risk of insolvency, and in any event amounted to transactions defrauding creditors within the meaning of IA 1986, s 423.

BAT succeeded on its claim under IA 1986, s 423 in respect of the 2009 dividend, in the sum of €135m. It was agreed that the question of the appropriate relief to be granted should be deferred for further evidence and argument. That took place at a further two-day hearing in January 2017.

PSL practical point: For further reading on the liability judgment, see News Analysis: 'When must directors start to consider the interests of creditors as a company approaches insolvency?'.

What were the main legal arguments put forward?

Sequana's primary submission was that because of very substantial changes that had occurred to the position of the parties since the 2009 dividend, it was impossible to restore the position to what it would have been had the transaction not taken place, and therefore no remedy ought to be granted. In particular, Sequana relied on:

- the sale of AWA by Sequana
- developments in the US litigation regarding the underlying environmental liabilities, and
- a funding agreement entered into by BAT, BTI, AWA and others resolving a complicated series of claims and counterclaims in several sets of proceedings and arbitrations to promote their common interest in maximising recoveries from certain third parties (including Sequana) to aid in the funding of the clean-up costs

Sequana's fallback submission was that that any remedy should take the form of a restoration of the inter-company debt between Sequana and AWA, the effect of which would be that Sequana's liability would be restricted to the sums AWA would be required to pay under the funding agreement, which were the only obligations owed to the victims of the IA 1986, s 423 transaction at the date of the hearing.

Further, Sequana argued that:

- the remedy should be framed by reference to a hypothetical transaction that could have been entered into without the IA 1986, s 423 purpose
- Sequana should not be required to meet liabilities which were remote at the time of the 2009 dividend, and
- amounts allegedly spent unwisely by AWA since the sale (eg, dividends and investments) should be deemed to be still available to meet its liabilities

What did the court decide, and why?

As regards Sequana's primary submission, although it was impossible to unravel everything that had happened since the 2009 dividend, it would be contrary to the statutory objective to decline to make an order. It would be unjust to BAT if that were treated as a reason to avoid attempting to provide a remedy to restore some of the benefit lost as a result of the impugned transaction. This was not a case in which any order would be otiose or the interests of the transferee should outweigh those of the victims of the IA 1986, s 423 transaction. As regards the specific matters relied upon by Sequana:

- the sale of AWA was what prompted the IA 1986, s 423 transaction in the first place
- there was no basis for supposing that events in the US would have played out in a way more favourable to AWA, and
- the funding agreement was to be regarded as a reasonable mitigation by the victims of their loss

As regards Sequana's fallback submission, the court's remedial discretion was not limited to the value of any obligations of the transferor to the victims at the date of the hearing—which would risk unfairness to the victims where a substantial period of time had elapsed since the date of the impugned transaction—and which was inconsistent with previous authority. It was specifically contemplated under the funding agreement that any recoveries resulting from the IA 1986, s 423 claim would be paid into BTI (for the purposes of clean-up) in addition to the amounts for which AWA was liable under

the funding agreement. Sequana's fallback submission would result in injustice, thwart the intentions of the parties to the funding agreement and not help restore the victims to their pre-transaction position or protect their interests.

The court also rejected Sequana's further arguments:

- there was no basis in principle or authority for the court stepping in to rescue the transferor and transferee from the consequences of their illegitimate transaction by investigating the amount they could legitimately have paid away when in fact they chose to pay away a larger amount
- there was authority that a remedy could be fashioned to protect a victim who was not in the contemplation of the transferor—it followed that a remedy could be fashioned to protect a victim who was within the contemplation of the transferor but in respect of a potential additional liability towards that victim that was not in the contemplation of the transferor
- in determining the appropriate relief under IA 1986, s 423, the court will not attempt to reconstruct a complete counterfactual pathway—in any event, it was not possible to be sure whether greater or lesser expenditure would have been incurred by AWA, and Sequana had much greater control than BAT over what happened within AWA in the relevant period

The court ordered Sequana to make an immediate payment of around $138m (being the amount by which the victims were already out of pocket) to BTI to be applied in accordance with the terms of the funding agreement and to make further payments as and when the victims were required to make them in respect of clean-up costs up to a ceiling of the level of the 2009 dividend plus interest.

PSL practical point: For further reading on the court's decision on costs in this case, see News Analysis: 'Costs orders, multiple claims and impecunious defendants (BTI v Sequana)'.

To what extent is this decision helpful in clarifying the law in this area?

This decision is consistent with and applies previous authority, and has provided further welcome clarification on the broad remedial discretion in response to a transaction that contravenes IA 1986, s 423. However, it may not be the last word on the topic—Mrs Justice Rose granted Sequana permission to appeal in relation to both liability and relief on the IA 1986, s 423 claim.

Interviewed by Susan Ghaiwal.

This article was first published on Lexis®PSL Restructuring & Insolvency on 8 March 2017. Click for a free trial of Lexis®PSL.

The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor