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Case No: A3/2017/0905 and A3/2017/0920 & 0921

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
MRS JUSTICE ROSE
HC-2014-001215
HC-2013-00376

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 6 February 2019

Before:

LORD JUSTICE LONGMORE
LORD JUSTICE DAVID RICHARDS
and
LORD JUSTICE HENDERSON

- -

Between:

BTI 2014 LLC	**Appellant**
- and -	
(1) SEQUANA S.A.	**Respondents**
(2) ANTOINE COURTEAULT	
(3) PIERRE MARTINET	
(4) CLIVE MOUNTFORD	
(5) MARTIN NEWELL	
(6) SELARL C. BASSE	

And between:

SEQUANA S.A.	**Appellant**
-and-	
(1) BAT INDUSTRIES PLC	
(2) WINDWARD PROSPECTS LIMITED	**Respondents**
(3) SELARL C. BASSE	

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Lord Goldsmith QC, Andrew Thompson QC, Ciaran Keller and Ben Griffiths (instructed by **Debevoise & Plimpton LLP**) for **BTI 2014 LLC** and **BAT Industries PLC**
Laurence Rabinowitz QC, David Mumford QC, James Kinman and Niranjan Venkatesan (instructed by **Skadden, Arps, Slate, Meagher & Flom (UK) LLP**) for **Sequana S.A.** and for **Messrs Courteault, Martinet, Mountford and Newell**
Selarl C. Basse did not appear and was not represented

Hearing dates: 5-8, 11 June 2018

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Approved Judgment

Lord Justice David Richards:

Introduction

1. There are two principal issues on this appeal. The first is the application of section 423 of the Insolvency Act 1986 to the payment of otherwise lawful dividends. The questions, in particular, are whether section 423 is capable as a matter of law of applying to the payment of such dividends and, if it is, whether on the facts of this case the dividend in question was paid with the requisite statutory purpose. The second issue concerns the duty of directors to have regard to the interests of creditors. In particular, when and in what circumstances does it arise, and does it ever arise when the directors are considering the payment of an otherwise lawful dividend?

2. These are only some of the issues that arose for decision by Rose J after a trial lasting 32 days. The claims related to two dividends paid by Arjo Wiggins Appleton Limited (AWA) to its parent company, Sequana SA. The first, of €443 million, was paid in December 2008 (the December dividend) and the second, of €135 million, was paid in May 2009 (the May dividend). Both dividends were challenged in these proceedings, in each case on the bases that (i) they were not lawfully paid in accordance with the provisions of Part 23 of the Companies Act 2006 (the "could not pay" claims), (ii) alternatively, they were paid in breach of the duty of the directors of AWA to have regard to the interests of its creditors (the "should not pay" claims), and (iii) in any event, the payment of the dividends fell within section 423.

3. The "could not pay" and the "should not pay" claims were brought against the directors who authorised the payment of the dividends and against Sequana as a constructive trustee. Those claims were originally brought by AWA, to which the directors' duties were owed, but it was replaced as claimant by BTI 2014 LLC (BTI) to which AWA assigned the claims. BTI is a corporate vehicle set up by BAT Industries plc (BAT) for this purpose. BAT brought the claim under section 423 in its own capacity as a potential creditor of AWA and thus, to use the statutory term, as a "victim" of the payment of the dividends.

4. In a comprehensive and impressive judgment, Rose J dismissed all the claims as they related to the December dividend and there is no appeal against that part of her decision. As regards the May dividend, the Judge dismissed the "could not pay" and the "should not pay" claims but gave judgment against Sequana under section 423. There is no appeal against her dismissal of the "could not pay" claim. With permission granted by the Judge, Sequana appeals against the judgment under section 423, and BTI appeals against the dismissal of the "should not pay" claim.

5. In the very broadest of terms, the dividends were paid at a time when AWA had ceased to trade and had one material liability. By reason of a complex series of corporate transactions, AWA was subject to contingent indemnity liabilities in respect of clean-up costs and damages claims arising out of river pollution in the United States. The assets of AWA were an investment contract which would pay out a maximum of $250 million, historic insurance policies with an expected recovery, subject to litigation, of US$100 million and an inter-company debt of some €585 million owed by Sequana to AWA (the Sequana debt).

6. Payment of the two dividends was made by way of set-off against the Sequana debt, reducing it to about €3.1 million. In accordance with the relevant statutory requirements, the directors of AWA estimated the likely exposure of AWA under its indemnity liabilities for the purpose of making provisions, if any, in its accounts against such liability. The Judge found that the directors' decisions as regards provisions were properly made and that the accounts were properly prepared, so that the dividends were paid in compliance with the applicable statutory regime.

Facts

7. For the purposes of this appeal, the material facts can be shortly stated.

8. In 1978, Appleton Papers Inc (API), a wholly-owned subsidiary of BAT, acquired two paper coating businesses operating in the Lower Fox River area in Wisconsin, USA. Under the terms of the business acquisition, API took over the liabilities of the seller, National Cash Register Company (NCR), including certain environmental liabilities, and BAT agreed to indemnify NCR against any failure by API to meet those liabilities.

9. In 1989, BAT established Wiggins Teape Appleton plc as the holding company of API and another paper business that it already owned. The following year, Wiggins Teape Appleton plc was demerged from BAT and later merged with a French paper manufacturer, changing its name to AWA.

10. The paper businesses acquired by BAT in 1978 had, in the 1950s and 1960s, been responsible for extensive pollution of the Lower Fox River. Starting in the 1990s, claims were notified against, among others, NCR and API under the (US) Comprehensive Environmental Response, Compensation and Liability Act 1980 (CERCLA). The claims related to clean-up costs and natural resources damages resulting from pollution of the river. The Judge gives a detailed account of CERCLA and the development of the claims at [47]-[98].

11. Under an agreement made in 1998 between NCR, API and BAT, it was agreed that certain environmental liabilities of the parties, including those relating to the Lower Fox River, would be shared up to a total of $75 million as to 45% by NCR and as to 55% by API and BAT. It was determined by an arbitration in 2005 that costs above $75 million would be shared as to 40% by NCR and as to 60% by API and BAT.

12. In 2000, AWA was acquired by Sequana for €1.3 billion. In 2001, API was sold by AWA to an employee buy-out company. As part of the sale, AWA indirectly indemnified API against all liabilities relating to the Lower Fox River in excess of $25 million, net of insurance recoveries, that it had undertaken under the 1998 agreement. API assigned to AWA its rights against third parties, including rights under insurance policies that had been taken out by BAT between 1978 and 1986 (the historic insurance policies). Through a subsidiary, AWA purchased from AIG a guaranteed investment contract, called the Maris policy, to provide funds to pay for all aspects of the Lower Fox River liability. The amount payable under the policy increased over time with investment returns but had reached its maximum of $250 million by November 2008.

13. Following the sale of API, AWA ceased to be a trading company. The proceeds of sale of its businesses and other receipts were lent over the years to Sequana, leading to the Sequana debt, which carried interest at the EURIBOR overnight rate plus 0.25%.

14. Following the resolution of some unrelated liabilities of AWA in 2008, Sequana and the directors of AWA explored ways of reducing the Sequana debt. At that time, as I have mentioned, AWA's assets comprised the Maris policy, the benefit of the historic insurance policies and the Sequana debt. AWA's only significant obligations were its contingent indemnity liabilities. The notes to the final accounts for the year ended 31 December 2008 record and give details of AWA's contingent indemnity obligations to API. It should be noted that subsequently, in February 2012, BAT brought proceedings in the Commercial Court in which it claimed that AWA and API were each obliged to indemnify BAT in respect of its liabilities to NCR. BAT's claim under section 423 was made explicitly on the basis that there was (at least) a triable issue in those proceedings and that in its claim under section 423 BAT "does not allege and does not need to prove that [AWA] and API were in fact obliged to indemnify BAT Industries at all material times in respect of its liabilities to NCR". Sequana accepted that this was sufficient to give BAT standing to bring a claim under section 423.

15. In accordance with Part 23 of the Companies Act 2006 and the applicable accounting standards, to which I will refer in more detail below, a provision of €62.8 million was made against this contingent liability in AWA's interim accounts approved in December 2008. The provision represented the difference between the amount recoverable under the Maris policy and the directors' best estimate of the liability. Under the applicable accounting rules, amounts that might be recoverable under the historic insurance policies could not be taken into account so as to reduce the provision. To the extent that the Sequana debt exceeded the provision, it represented net assets in the accounts that were, on the face of the accounts, surplus to AWA's requirements. The net assets shown in the interim accounts amounted to €517 million, represented by paid-up share capital of €318.6 million, share premium account of €69.8 million and distributable reserves of €128.6 million.

16. Sequana and the directors of AWA decided that a dividend of €443 million should be paid to Sequana. In order to achieve this, the board of AWA resolved to reduce its paid-up share capital from €318.6 million to €1 million and to cancel the share premium account, using the procedure set out in section 641(1)(a) of the Companies Act 2006. This increased the distributable reserves by €387.4 million and the board of AWA resolved on 17 December 2008 to pay the December dividend by way of set-off against the Sequana debt, reducing the debt to €142.5 million. Following these steps, AWA's paid-up share capital was €1 million and its distributable reserves, as shown in its final accounts for the year ended 31 December 2008, were €137 million.

17. In the early months of 2009, intensive work was undertaken on the provision for the contingent liability to be included in the final accounts for the year ended 31 December 2008. By a process described in detail by the Judge, the conclusion was reached that the Maris policy was sufficient to cover the best estimate of the liability and that therefore it was not necessary to include a provision in the accounts. The accounts were audited by Pricewaterhouse Coopers (PwC) who gave an unqualified certificate that they gave a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of AWA's affairs as at the year

end and of its profit for the year and that the accounts had been properly prepared in accordance with the Companies Act 1985 (which was then the applicable legislation). They added an "emphasis of matter" statement, to which I will later refer.

18. The final accounts for 2008 showed distributable reserves of €137 million. In accordance with Part 23 of the Companies Act 2006, these reserves were lawfully distributable, and on 18 May 2009, the board of AWA resolved to pay an interim dividend of €135,181,358 by way of set-off against the Sequana debt, reducing it to about €3.1 million.

19. Whether the accounts complied with the applicable statutory provisions and accounting standards, and whether consequently the May dividend was lawfully paid, depended critically on the elimination of the provision against the contingent indemnity liabilities. As with the December dividend, this was the subject of sustained challenge at the trial but, having heard extensive factual and expert evidence, the Judge held that the directors' decision to eliminate the provision was properly taken and the accounts were properly prepared. This has not been challenged on appeal and, as BAT and BTI therefore accept, the May dividend was paid in compliance with Part 23 of the Companies Act 2006.

20. The May dividend was paid in contemplation of the sale by Sequana of AWA to a company owned by Christopher Gower and Brian Tauscher. Mr Gower had been general counsel for AWA since 2001 and had been intimately involved in dealing with the CERCLA claims. Mr Tauscher had been counsel to AWA in relation to insurance issues in respect of those claims. It was important to Sequana that, under the terms of the sale, it retained the right to share in any future surplus resulting from an excess of lump sum settlements with the insurers over any amounts payable under AWA's indemnity. At the same time, Sequana was no longer exposed to the risk that its debt to AWA would be called to fund indemnity payments. Pierre Martinet, a director of Sequana and AWA, ended a memo to the board of Sequana dated 18 May 2009 by saying that "Altogether, we believe it's a good deal which, for all intents and purposes, allows Sequana to get rid of a very hairy issue under favourable terms, while greatly limiting its future exposure to the Fox matter, if any at all". The minutes of a Sequana board meeting on 27 May 2009 expressed the same thought in more sedate language: "The immediate effect of this operation was to externalise a significant underlying risk that was difficult to control from the scope of the group, with Sequana having expressly excluded any guarantee under the sale contracts of API and the Fox River risk."

The law governing the payment of dividends

21. Although no issue arises directly on the application of Part 23 and the other requirements applicable to the legality of a dividend, they are relevant to the issues that do arise on this appeal, and it is convenient to refer to them now.

22. Part 23 of the Companies Act 2006 contains the statutory code applicable to determining the profits that a company may lawfully distribute to its shareholders. It was first introduced by the Companies Act 1980, to give effect to the Second EC Directive on Company Law (O.J. 1977 L 26/1), but it did so on a broader basis by applying it to private, as well as public, companies. The central provision is that a company may make a distribution only out of profits available for the purpose

(distributable profits) and that such profits are its accumulated, realised profits less its accumulated, realised losses: section 830. The determination of distributable profits is by reference to specified items in the company's "relevant accounts": section 836. Those items are profits, losses, assets and liabilities, share capital and reserves, and, importantly in the present case, provisions including (at the relevant times) those mentioned in paragraph 89 of schedule 4 to the Companies Act 1985:

> "References to provisions for liabilities or charges are to any amount retained as reasonably necessary for the purposes of providing for any liability or loss which is either likely to be incurred, or certain to be incurred but uncertain as to amount or as to the date on which it will arise."

23. "Relevant accounts" are the last annual accounts or, where a proposed dividend would contravene Part 23 by reference to those accounts, interim accounts. In the present case, the December dividend was paid by reference to interim accounts showing the effect of the reduction of share capital effected on 15 December 2008 and the May dividend was paid by reference to the annual accounts for 2008. To qualify as "relevant accounts", the last annual accounts must have been properly prepared in accordance with the Companies Act and, if subject to audit, given an unqualified audit report (with special provisions if the report is qualified, which it was not in this case). Interim accounts need not be audited but they must be properly prepared in accordance with sections 395-397 and they must be such as to enable a reasonable judgment to be made as to the items mentioned in section 836. Sequana and the other defendants accepted that there was no difference for present purposes between the requirements for annual accounts to show a true and fair view and for interim accounts to enable a reasonable judgment to be made of the relevant items.

24. The interim and final accounts in the present case were challenged on the grounds that (i) the capital reduction in December 2008 was ineffective as a matter of law and therefore the accounts overstated the distributable profits; (ii) the provision in respect of the indemnity liabilities was inadequate; and (iii) the accounts failed to give adequate disclosure of AWA's contingent liabilities. The Judge rejected the challenge to the capital reduction and it is unnecessary to say anything about grounds (i) and (iii).

25. As regards ground (ii), the adequacy of the provision against the indemnity liabilities, this was in large part governed by the detailed provisions of *Financial Reporting Standard 12: Provisions, Contingent Liabilities and Contingent Assets*, issued by the Accounting Standards Board. The Judge summarised at [373]-[377] the salient features of FRS 12. She considered in great detail at [105-206] and [257-289] the process by which the provisions in the interim and annual accounts had been arrived at and held that they were properly made.

26. Before the Companies Act 1980, the legality of dividends was determined by common law rules. Many of those rules were superseded by the statutory provisions but section 851(1) of the Companies Act 2006, re-enacting earlier provisions to the same effect, provides that "the provisions of this Part are without prejudice to any rule of law restricting the sums out of which, or the cases in which, a distribution may be made". The most important of these rules of law is that a distribution to shareholders must not be made out of capital, established by the decision of the House of Lords in *Trevor v Whitworth* (1887) 12 App Cas 409. The continued relevance and application

of this rule was demonstrated by the decision of Hoffmann J in *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626. In the present case, the claimants accepted that their pleaded claim for breach of common law rules added nothing to their claims that the dividends contravened Part 23.

27. I will revert later to the particular relevance of these statutory and common law rules when dealing with issues as to the duties of directors, but the point of general importance in this case is that the December and May dividends were held by the Judge to have been paid in compliance with these rules, and no appeal has been brought against those findings.

28. I turn therefore to the issues on this appeal, dealing first with Sequana's appeal in BAT's claim under section 423.

Section 423 Insolvency Act 1986: introduction

29. Section 423 is a wide-ranging provision designed to protect actual and potential creditors where a debtor takes steps falling within the section for the purpose of putting assets beyond their reach or otherwise prejudicing their interests. Unlike other provisions of the Insolvency Act 1986, proceedings under it are not confined to formal insolvency proceedings but may be brought at any time by any actual or potential creditor who claims to have been prejudiced. It also differs from other provisions in being focused on the subjective purpose of the debtor. Although enacted in new form in the Insolvency Act, the cause of action has a venerable history, going back to the *actio pauliana* in Roman law (see *The Institutes of Justinian* IV.VI.6) and to the Statute of Elizabeth 1571 (13 Eliz 1, c. 5) in English law. It was re-enacted in section 172 of the Law of Property Act 1925 before being replaced by section 423.

30. The types of transactions to which the section applies are defined by section 423(1):

> "(1) This section relates to transactions entered into at an undervalue; and a person enters into such a transaction with another person if-
>
> (a) he makes a gift to the other person or he otherwise enters into a transaction with the other on terms that provide for him to receive no consideration;
>
> (b) he enters into a transaction with the other in consideration of marriage or the formation of a civil partnership; or
>
> (c) he enters into a transaction with the other for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by himself.

31. Section 436 contains a non-exhaustive definition of "transaction" for the purposes of the Act "except in so far as the context otherwise requires": it "includes a gift, agreement or arrangement, and references to entering into a transaction shall be construed accordingly".

32. By section 423(2), the court may, if the claim is established, make such order as it thinks fit for "(a) restoring the position to what it would have been if the transaction had not been entered into, and (b) protecting the interests of persons who are victims of the transaction".

33. For the reasons earlier mentioned, it was common ground that BAT had standing to bring the claim as a "victim" of the payment of the May dividend. The judge held that BAT's claim was well-founded and ordered that Sequana should pay to BTI sums, not exceeding the amount of the May dividend plus interest, in respect of past and future payments made by API and BAT in respect of remediation costs relating to the Lower Fox River and other rivers.

34. Sequana appeals on two grounds. First, a dividend is not "a transaction at an undervalue" within the meaning of section 423(1). Second, the May dividend was not paid with the purpose of putting the dividend monies beyond the reach of BAT or otherwise prejudicing BAT's interests within the meaning of section 423(3).

Section 423: is a dividend "a transaction at an undervalue"?

35. There are three issues arising under this ground. The first is whether a dividend is a gift within the meaning of section 423(1). This was not an issue before the Judge because BAT did not put its case on this basis, but it seeks to raise it on appeal as an alternative ground to support the judge's decision. The second is whether, if not a gift, a dividend is a transaction "on terms that provide for [the payee] to receive no consideration". This is the basis on which BAT put its case at trial. The third is whether, if not a gift, the payment of a dividend involves a "transaction" within the meaning of section 423(1). Although the third issue is logically prior to the second, it is convenient to deal with the second issue immediately following the first.

36. The articles of association of AWA were entirely typical in providing that a dividend could either be paid with the authority of a board resolution or be declared by the company in general meeting, but, in that case, not for more than the amount recommended by the directors. The declaration of a dividend, but not a resolution of the directors to pay a dividend, creates a debt due from the company to the shareholders.

Section 423: is a dividend a gift?

37. Before referring to the way the judge dealt with the issues before her, I will address BAT's submission that a dividend constitutes a gift for the purposes of section 423(1). Although it was therefore for BAT to make good its case on this new point, Mr Rabinowitz QC on behalf of Sequana addressed it as the first step in his argument because, he submitted, it shed light on the second limb of section 423(1)(a). If, as he submitted, the May dividend was not a gift, that supported his case that for the same reasons it was also not a transaction for no consideration under the second limb.

38. The core of Mr Rabinowitz's submissions on this point was that, rather than being a gift, a dividend paid on a share was a return on the investment that the shareholder, or the original subscriber of the share, had made when the share was issued. As is often said, a share is a bundle of rights, one of which is the right to receive any dividends declared or paid on the share. The right arising if a dividend is declared or paid is not

independent of the original investment but is the return on the investment. If that investment had not been made, no such right would arise. Purchasers of shares, once subscribed and issued, will not provide consideration to the company for those shares (unless, very unusually, they are not fully paid) but purchasers succeed to the rights originally acquired through the issue of the shares to the subscribers.

39. Mr Rabinowitz had an additional submission on this point, that BAT's case would create arbitrary distinctions between different types of dividend. First, if shares were issued on terms that their holders were entitled to the payment of dividends without prior declaration or board resolution, as might well be the case with preference shares, it could not be said that such dividends were gifts. I agree but it does not follow that other, discretionary dividends would not be gifts. Second, a shareholder does have an enforceable right to the payment of a dividend if and when it is declared by the company in general meeting. While true, this treats the payment as separate from the declaration which, in my judgment, is artificial. The declaration and payment of a dividend is a single process. Mr Rabinowitz was candid in attaching little weight to these points, describing them as half a point, and they could not, in my view, bring him success on the gift issue if he failed on his principal submission that dividends were a return on the investment in the shares.

40. On behalf of BAT, Mr Thompson QC relied on the fact that in most cases a shareholder had no right to the payment of dividends. A right to be paid a dividend on a share only if one is declared or resolved to be paid was, he said, insufficient to establish that the dividend is anything other than a gift. If that was wrong, he submitted that the word "gift" in section 423(1) should be given a broad meaning so as to avoid the possibility of payments that clearly should be within the ambit of section 423 escaping its reach.

41. In my judgment, Mr Rabinowitz's submission is correct. For the reasons he gave, rights are conferred on shareholders as regards dividends by the terms of issue of the shares or by the articles, and it is pursuant to those rights that shareholders receive dividends. Those rights are attached to the shares for which consideration was provided by the original holders. Dividends are both commercially and legally a return on the investment. It would be startling to categorise dividends as gifts made by a company to its shareholders and there is no reason to think that Parliament intended the word "gift" to carry anything other than its usual meaning.

Section 423: is a dividend a transaction for no consideration?

42. Turning to the second issue, whether a dividend was a transaction on terms that the payee would receive no consideration, Sequana relied heavily before the Judge, as before us, on Lord Millett's analysis of dividends in a tax case, *Inland Revenue Commissioners v Laird Group plc* [2003] UKHL 54, [2003] 1 WLR 2476 (*Laird*), for the proposition that the transaction pursuant to which a dividend is paid is not the resolution of the directors or the declaration of the dividend but the antecedent contract deemed to exist between the company and its members by virtue of section 33 of the Companies Act 2006 ("The provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions").

43. The Judge held that Lord Millett's analysis of the nature of a dividend for the purposes of the statutory tax provisions at issue in Laird could not be read across to section 423. She said at [500]:

> "In construing section 423 I accept Mr Thompson's submission that the wording of section 423 is deliberately wide in order to protect creditors from assets being moved from the potential debtor out of their reach. Subsection (1) is drafted to exclude transactions only where the consideration received by the potential debtor is not significantly less in value than the consideration that the debtor receives. Where the consideration provided by the debtor and the other party to the transaction are roughly the same, there can be no detriment to the creditor because the debtor's assets are not depleted. But where they are not, then the creditor is less likely to be able to recover what is owed to him. There may be a situation where the consideration paid by the debtor to the third party is fixed in a contract but payment is delayed. Provided that the initial contract was not entered into with the s 423 purpose, that delayed payment is not a transaction with the s 423 purpose because the purpose is to fulfil the contractual obligation to make payment. The payment may have the consequence of depriving other creditors of money later, but as Arden LJ emphasised in *Hashmi*, consequences are different from purposes. The payment of the dividend is not, in my judgment, the satisfaction of an earlier obligation in the same way. It is true that the reason why the member of the company, rather than any other person, receives the dividend is because of the pre-existing relationship of company and shareholder. But the decision to pay the dividend and choice of its value is not the consequence of that relationship because it is discretionary not only in its amount but in whether it is paid at all."

44. The Judge also rejected Sequana's submission that there was no lacuna in the protection of creditors if dividends are outside the scope of section 423 because they are adequately protected by Part 23 of the Companies Act 2006 and by the fiduciary duties of directors. She said at [501]:

> "First, the only possible claimant in respect of those other causes of action is the company itself whereas the class of claimants here is much wider under section 424. Secondly, the powers of the court to put matters right under sections 423(2) and 425 are much broader and more flexible than the remedies available under Part 23. It is not difficult to see that a blanket exclusion of dividend payments from the scope of section 423 will quickly reduce the efficacy of the provision given the many instances where the directors and shareholders of a company are the same or linked individuals."

45. Sequana seeks to derive from *Laird* the proposition that, in paying a dividend, a company is merely giving effect to the rights that the shareholders already have and

paying to them what is already theirs. It is irrelevant that a shareholder's right to receive a dividend is conditional on the declaration of the dividend or on a resolution of the directors to pay a dividend. The decision to pay a dividend is properly characterised as being a release to the shareholders of that to which they are presumptively entitled, namely the surplus available for distribution. It follows that, given that the payment of a dividend gives shareholders what is theirs, it makes no sense to speak of a dividend as a transaction for which the company receives no consideration.

46. In my judgment, Lord Millett's speech in *Laird* will not support this submission. The issue in *Laird* was whether the payment of a dividend on ordinary shares was "a transaction relating to securities" for the purposes of the definition of "a transaction in securities" in section 709(2) of the Income and Corporation Taxes Act 1988. Lord Millett regarded as an important indication of Parliament's intention that section 703(2) demonstrated that the liquidation of a company did not constitute a transaction relating to securities, although it would result in the distribution of any surplus to shareholders. He observed at [30] that before the introduction of section 703(2) "the question whether the payment of a dividend on ordinary shares was a transaction relating to securities was a question of some nicety" but its introduction casts light on the issue, because it cannot be said that the liquidation of a company does not affect its shares or the rights of its shareholders. This in turn led to "the critical questions" which Lord Millett stated at [34] to be:

> "(i) why is the payment of the undistributed profits of the company to the shareholders in the course of a liquidation not a transaction relating to their shares? and (ii) what if any is the difference between the payment of the undistributed profits to the shareholders in the course of a liquidation and their distribution to shareholders by way of dividend while the company is a going concern? In both cases the payment to each shareholder is made in respect of his shares."

47. Taking first a distribution of surplus in a liquidation, Lord Millett said at [37]:

> "Once realised the assets of a company in liquidation are a distributable fund in the hands of the liquidator, who no longer needs funds with which to carry on its undertaking. After the creditors have been paid and the amounts credited as paid up on the shares have been repaid, the balance is distributable to the ordinary shareholders because it belongs to them, subject only to the liquidator's discretion to retain sufficient funds in his hands to enable him to complete the winding up. The distribution of the undistributed profits of a company in liquidation to its shareholders is not a transaction relating to securities because neither the shares themselves nor the rights attached to them are affected by a payment which merely gives effect to the shareholders' rights; they receive only what is already theirs. Distributions are made to shareholders in respect of the shares, but the shares of the individual shareholder are nothing more than the measure of the proportion of the total which is due to him."

48. Lord Millett did not regard the position as regards dividends to be materially different. While the right to receive a dividend does not arise until the conditions laid down in the company's articles of association are satisfied, which will normally involve a resolution of the directors either to pay a dividend or to fix the maximum to be declared by the company in general meeting, "the directors *effectively* release funds due to the shareholders from their power to retain them in the business" (emphasis added). Lord Millett concluded at [42]:

> "Whether the company is in liquidation or continuing to carry on business as a going concern, therefore, the distribution of the undistributed profits of a company to the shareholders entitled thereto merely gives effect to the rights attached to the shares. The funds are released, in the one case from the liquidator's discretion to retain them for the purpose of the winding up, and in the other from the directors' discretion to retain them for the purposes of the undertaking. Given that the former is not "a transaction relating to securities", neither in my opinion is the latter. The relationship between the payment and the shares in respect of which it is paid is the same in both cases."

49. The essential feature of Lord Millett's reasoning is that a dividend is not "a transaction relating to securities" but merely gives effect to the right attached to the shares to receive a dividend if the necessary pre-conditions are satisfied. The position in a liquidation points to this solution of what was otherwise "a question of some nicety". When Lord Millett said that the directors "effectively release funds due to the shareholders", he was not suggesting that prior to the necessary resolution or other steps being taken, the funds representing undistributed profits were not beneficially owned by the company or were in some way the property of the shareholders.

50. Once it is accepted that the payment of a dividend involves the payment of funds beneficially owned by a company to its shareholders, the question under section 423(1) remains whether the terms on which the dividend is declared or paid "provide for [the company] to receive no consideration". In my judgment, it cannot be said that the company receives consideration for the payment of a dividend. It is not enough to say that the dividend is paid in accordance with the rights attached to the shares, where those rights are quite different from, for example, the right to receive interest payments on loan notes or the right to be considered for bonus declarations on a with-profits fund. If and when a company pays a dividend to shareholders, the terms of the dividend do not provide for the company to receive any consideration nor will it receive any consideration. It might be said that to come within the second limb of section 423(1)(a) the terms must expressly provide for no consideration but in my view that would be too literal a reading of the provision. Parliament can hardly have intended the operation of the section to depend on the vagaries of drafting styles.

Section 423: was the May dividend a "transaction"?

51. This leaves the third issue, whether the payment of the May dividend constituted "a transaction" for the purposes of section 423(1). Sequana submitted that a dividend is not a transaction within section 423(1) at all. BAT submitted that a dividend was such a transaction but, even if that were not always the case, the circumstances of the May dividend made clear it was the case for that dividend.

52. Mr Rabinowitz submitted that the language of section 423(1) requires, save in the case of a gift, an element of dealing between the parties. After stating that section 423 "relates to transactions entered into at an undervalue", sub-section (1) provides that "a person enters into such a transaction with another person" if one of paragraphs (a), (b) or (c) is satisfied. This requirement for mutual dealing is emphasised by the terms of the second limb of paragraph (a) ("or otherwise enters into a transaction with the other").

53. The bilateral nature of the relevant transactions, requiring at least some element of dealing between the parties to the transaction, has been emphasised in a number of first instance decisions: see *Re Taylor Sinclair (Capital) Ltd* [2001] 2 BCLC 176 at [20], *Re Simon Carves Ltd* [2013] EWHC 685 (Ch), [2013] 2 BCLC 100 at [25] and *Re Hampton Capital Ltd* [2015] EWHC 1905 (Ch), [2016] 1 BCLC 374. In the last of these cases, George Bompas QC, sitting as a Deputy High Court Judge, said at [38] "the mere transmission of money, the mere making of a payment, without any form of dealing between the paying company and the payee" could not constitute the entering into a transaction by the company with the payee and that "Without straining the language of the section, this must require some engagement, or at least communication, between the two parties and not merely a disposition of money which results in one party's money landing up in the bank account of the other without anything said or done by that other".

54. Mr Rabinowitz placed some emphasis on *Clarkson v Clarkson* [1994] BCC 921. In that case, the three directors and shareholders of a company each took out life insurance on their own lives. Each policy was held by the three directors on express trusts. In the case of Mr Clarkson's policy, it was held, subject to a discretionary power of appointment in favour of his wife, on trust for the other two directors in equal shares. In 1991, the company became insolvent and guarantees given by the directors were called which they were unable to meet. As trustees of Mr Clarkson's policy, the three directors exercised the power of appointment in favour of his wife. Bankruptcy orders were made against each of them in early 1993. Their trustees in bankruptcy brought proceedings against Mrs Clarkson under section 339 of the Insolvency Act 1986. Section 339, like section 238 which applies to companies, enables recovery to be made by the trustee if the debtor or company has entered into a transaction at an undervalue within a specified period before the bankruptcy order at a time when the debtor was or thereby became insolvent. The test for a transaction at an undervalue is the same as in section 423. It was contended by the trustees in bankruptcy that the trustees had made a gift to Mrs Clarkson of the trust property which otherwise belonged to the other two directors.

55. On a first appeal, HH Judge Weeks QC, sitting as a Deputy High Court Judge, held that the claim failed. His primary reason was that the appointment in favour of Mrs Clarkson did not constitute a transaction at an undervalue, as defined. The exercise of the trustees' power of appointment was neither a gift nor did it involve entering into a transaction with another person. He noted the two limbs of section 339(3)(a) (the equivalent of section 423(1)(a)) and said:

> "I thought at one time that some inference could be drawn from the word 'otherwise', but in view of the extended definition of transaction to include a gift I do not think that any necessary inference can be drawn from the word 'otherwise', because gift

> is included in the definition section of the Insolvency Act. So no emphasis can be placed on 'otherwise', which is correctly there in any event."

56. The decision of Judge Weeks was upheld by this Court, but on a different ground. Hoffmann LJ, with whom Stuart-Smith and Saville LJJ agreed, held that the gift was made by Mr Clarkson when he established the trust, outside the period relevant for section 339. The appointment by the trustees was merely the exercise of a fiduciary power to select the person to whom the gift should go and, being an appointment under a special power, it took effect as if it had been written into the trust instrument. Mrs Clarkson took the property of the settlor, not of the donee of the power. Commenting on the terms of section 339(3)(a), Hoffmann LJ said at p.929:

> "The second part of this definition does not easily fit into the circumstances of the appointment to Mrs Clarkson. True, she gave no consideration, but this was not because of the terms of the transaction as that phrase might be ordinarily understood. The appointment in her favour was unilateral and unconditional. If it was a transaction it contained no terms as to consideration at all. It would be more natural to say that Mrs Clarkson received a gift. The real question is, from whom did she receive the gift?"

57. While Mr Rabinowitz's submissions based on the language of section 423(1) have some force, I am not persuaded that a dividend paid by a company is not within the scope of the provision.

58. First, the language of section 423(1) does not in my judgment preclude its application to the payment of a dividend, even if it is treated as a unilateral act by a company. I have earlier referred to the definition of "transaction" in section 436(1): it "includes a gift, agreement or arrangement, and references to entering into a transaction shall be construed accordingly". There are two relevant points to note. First, it is an inclusive, not an exhaustive, definition. A dividend is capable of coming within the definition of transaction, even if it is not a gift, agreement or arrangement. Second, Lord Reid observed in *Greenberg v IRC* [1972] AC 109 at 136-137, a case like *Laird* that concerned whether dividends were transactions relating to securities, that "The word "transaction" is normally used to denote some bilateral activity but it can be used to denote an activity in which only a single person is engaged". The inclusion of a gift within the definition in section 436(1) suggests, like the definition of transactions in securities, that no bilateral element is necessary. In my view, it is not correct to read the inclusion of a gift as providing an exception to the definition. The statutory definition should be read according to its own terms. Third, the bilateral element may be said to come, not in the definition of "transaction", but in section 423(1) which provides in its opening words that "a person enters into such a transaction with another person" if one of sub-paragraphs (a) to (c) is satisfied. The first limb of paragraph (a) applies if the person makes a gift, a unilateral act. The language and structure of section 423(1) thus pre-suppose, in my judgment, that making a gift involves *for the purposes of section 423* (and for the purposes of the other sections where the same form of words is used) entering into a transaction with another person. This is emphasised by the words of the second limb ("or he *otherwise* enters into a transaction"). For these reasons, I do not accept Judge Weeks' view in *Clarkson*

v Clarkson, not endorsed by this Court on appeal, that the word "otherwise" can be discounted because of the inclusion of a gift in the definition of "transaction".

59. I do not say that this question is to be decided purely by a process of linguistic analysis, but I do say that the language does not dictate the answer that the only unilateral act capable of falling within section 423(1) is a gift.

60. Given the purpose and history of section 423, there is no policy reason that anyone has identified, certainly in the submissions and citations of authorities and academic writings made to us, for confining it to gifts and bilateral transactions. Mr Rabinowitz was hard pressed to think of any transaction that would come within the second limb of paragraph (a), read as he contended. But if a gift is included, why should not a dividend (assuming it to be unilateral) or other unilateral transaction be included? The harm to actual or potential claimants against the company or individual debtor would be the same. Mr Rabinowitz accepted in argument that a dividend *in specie*, which would involve the transfer of non-cash assets from a company to its shareholders, would be a transaction to which section 423 applied. If he was right, and in my view he was, it is surprising if the section does not apply to the payment of a cash dividend. The statutory provisions that preceded section 423 extended to any transfer of property, but they did not apply to the payment of money. The most significant change introduced by section 423 was to extend the scope of the provision to include the payment of money. I accept that the section must be read as a new provision, but the suggested limitation does not fit well with the development of a remedy designed to deal with transactions deliberately designed by debtors to prejudice the interests of actual or potential creditors.

61. I have so far proceeded on the basis that a dividend is ordinarily to be regarded as a unilateral act of the company. I do not, however, accept that this is the right approach. As earlier discussed, a dividend is paid pursuant to and in accordance with the rights of the shareholders under the company's articles of association. A dividend is a return on the shareholders' investment. Shareholders may well not be involved in the decision to pay a particular dividend, and in large companies that will commonly be the case, but given the context in which they come to be paid, I regard it as too narrow to say that a dividend is a unilateral act. It is not, in Mr Bompas QC's words in *Re Hampton Capital Ltd*, "merely a disposition of money which results in one party's money landing up in the bank account of the other without anything said or done by that other".

62. Finally on the general question whether a dividend falls within section 423(1), Sequana submitted that to construe section 423 as applying to a dividend would cut across the statutory regime in Part 23 of the Companies Act 2006 which is designed for the protection of creditors. I do not accept this submission for a number of reasons. First, section 423 and its predecessors are wholly unrelated to the Companies legislation and, specifically, Part 23 of the Companies Act 2006. It is in different legislation and is not confined to companies. There is no warrant for reading section 423 as qualified by Part 23. Second, on the contrary, Part 23 makes this clear. Section 852 provides that "The provisions of this Part are without prejudice to any enactment, or any provision of a company's articles, restricting the sums out of which, or the cases in which, a distribution may be made". Third, there is no conceptual difficulty in an otherwise lawful dividend being paid for the purpose of putting assets beyond the reach of actual or potential claimants, and there is no difficulty in envisaging a

dividend being paid for that purpose. A dividend is no different from any other lawful transaction which is entered into for such purpose.

63. In my judgment, therefore, the payment of a dividend is within the scope of section 423(1), even if it cannot be said to involve an agreement or arrangement between the company and the shareholders.

64. However, in any event, on the facts of this case the May dividend did form part of an arrangement between Sequana and AWA. As is to be expected in the case of a wholly-owned subsidiary, Sequana as the holding company was closely involved in the decision to pay the May dividend. The formalities of the dividend demonstrate the arrangement. The dividend was not paid in cash but, with the agreement of Sequana, was set off against the Sequana debt. Both companies executed a "cross-receipt" for this purpose and, at their meeting on 18 May 2009, the directors of AWA resolved to pay the dividend and to approve and execute the cross-receipt.

Section 423: the statutory purpose

65. A transaction is subject to section 423 only if the requirements of section 423(3) as to purpose are satisfied. It provides:

> "In the case of a person entering into such a transaction, an order shall only be made if the court is satisfied that it was entered into by him for the purpose-
>
> (a) of putting assets beyond the reach of a person who is making, or may at some time make, a claim against him, or
>
> (b) of otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make."

66. This is essentially a question of fact. The purpose of a person in entering into a transaction is matter of the subjective intention of that person: what did he aim to achieve? Section 423(3) does not require the specified purpose to be the sole or dominant purpose. It is sufficient if it "can properly be described as a purpose and not merely as a consequence, rather than something which was indeed positively intended": *IRC v Hashmi* [2002] EWCA Civ 981, [2002] 2 BCLC 489 at [23] per Arden LJ.

67. Sequana's challenge is that the Judge failed to make the finding that was required by section 423(3). It emphasises, correctly, that the relevant purpose is that of the person entering into the transaction, in this case AWA. It submits that instead of making findings about AWA's purpose, the Judge wrongly focused only on Sequana's purpose. Sequana accepts that it might have been open to the Judge to find that AWA's purpose, or one of its purposes, fell within section 423(3) but, as she did not address that question, the case should be remitted to her to make findings as to AWA's purpose. Further, the Judge did not distinguish, or sufficiently distinguish, the two events that occurred on 18 May 2009: the May dividend and the sale of AWA by Sequana. In so far as the Judge identified AWA's purpose, it was to assist Sequana to dispose of AWA and thereby to terminate any moral responsibility for the debts of Sequana, which was not a purpose falling within section 423. As regards the May

dividend, the furthest the Judge went was to find that its purpose was to eliminate the Sequana debt and so clear the way to the sale of AWA.

68. In the face of this challenge, it is necessary to set out the relevant parts of the judgment. At [503]-[505], the Judge rejected BAT's case that the December dividend was paid with the statutory purpose. At [503], she clearly addressed AWA's purpose, saying that she had earlier described the evidence of the four directors of AWA as to their intentions in declaring the December dividend and that she was "fully satisfied that the directors cannot have had the s.423 purpose in declaring that dividend". There was then no settled intention to sell AWA outside the Sequana group. In this connection it was important that Sequana's policy was to stand by its subsidiaries. Even if the Sequana debt were completely eliminated, Sequana would not escape the risk of escalating liabilities under the guarantee to BAT while AWA remained a subsidiary.

69. At [506ff], the judge considered the purpose of the May dividend, beginning with her conclusion at [506]:

> "There is, in contrast, plenty of evidence to show that the intention of AWA, through the governing minds of Mr Martinet and Mr Courteault, in declaring the May Dividend was to remove from the Sequana group the risk that the indemnity liability to BAT for the Lower Fox River clean up might turn out to be much more than the amount available from the Maris Policy plus the Historic Insurance Policies receipts."

70. At [507]-[510] the Judge examined the evidence, in particular the evidence of Mr Martinet and Mr Courteault, the remaining directors of AWA, finding that Sequana wished to be rid of the "very hairy situation" that its continued ownership of AWA represented. At [511]-[513] the judge said:

> "511. There may well have been legitimate business reasons for Sequana wishing to rid itself of the risk that the Maris Policy and the Historic Insurance Policies would ultimately not be enough to enable AWA to fulfil its indemnity obligations. But there is no requirement in section 423 for the transferor to be motivated by some ill will towards a particular creditor or to be acting dishonestly (although many of the cases in which section 423 is relied on are cases of dishonesty). The removal of the 'scary' item on Sequana's balance sheet could only be achieved if the May Dividend could be paid by off-setting it against the remaining inter-company receivable so that the company could be sold. That was the purpose of the transaction.
>
> 512. Mr Foxton argued that the purpose of the sale of AWA might have been to remove the liability from Sequana's account but the transaction being challenged here under section 423 is not the sale as such but the payment of the dividend. Further, he submitted, there is no evidence that the dividend payment was motivated by the desire to remove any risk of further liability from Sequana. I do not accept that one can distinguish between

> the purpose of paying the dividend and the purpose of selling the company in that way by the time the May Dividend came to be paid. Both Mr Martinet and Mr Courteault knew what the sequence of events would be on the evening of 18 May 2009 during the series of board meetings that they held over the telephone. It is clear from *Hill v Spread Trustee* referred to earlier that it is enough if the impugned transaction is entered into with the s 423 purpose; it does not have to achieve that purpose by itself:
>
> > "102. … If the transaction is entered into with the requisite purpose, the fact that some other event needs to occur does not mean that the transaction cannot itself be within section 423(3). I consider that this is what the judge meant by his test of whether the transaction was an essential part of the purpose. … The right approach in my judgment is to apply the statutory wording. It is enough if the transaction sought to be impugned was entered into with the requisite purpose. It is entry into the transaction, not the transaction itself, which has to have the necessary purpose."
>
> 513. I have no doubt here that the payment of the May Dividend was entered into with the purpose of eliminating the receivable which then cleared the way to AWA being sold and to Sequana removing any risk of having to fund the indemnity itself if the funds left in AWA proved to be inadequate."

71. At [516], the Judge said:

> "The Claimants rely on the very particular circumstances of this case. AWA was a non-trading company and a wholly owned subsidiary. Its only function was as a containment vehicle for the Fox River liability. There is clear evidence that the purpose of the declaration of the May Dividend and the sale of AWA to TMW clearly was to remove from Sequana the risk that the Maris Policy plus the insurance proceeds might not be enough to meet the indemnity. Such evidence of the subjective intention of those in control of the company when making the decision to pay the dividend will distinguish this case from other cases where directors declare dividends for their shareholders for the usual reasons for which dividends are paid, without turning their minds to whether this leaves enough money for potential creditors. Here there is no doubt that the subjective intention of the directors at the time of the May Dividend and the sale was to prevent AWA having any legal or moral call upon its parent company to meet its creditors' claims. After the declaration of the dividend and the sale to TMW, the creditors were prejudiced because the assets of AWA had been depleted and it no longer had any call on Sequana to that extent."

72. Finally, at [518]-[519], the Judge said;

> "518. … AWA received advice and, as I have held, properly took the view that the best estimate of its liability under the indemnity was $143 million, covered by the Maris Policy. But Mr Martinet and Mr Courteault were well aware of the great uncertainties that existed over the ultimate level of remediation and NRD [natural resources damages] costs. The size of NCR/API's share would be determined perhaps only after many years of the further litigation. It may have been an unlikely scenario and I have held that it was not sufficiently likely to generate a duty to take account of BAT's interests when declaring the May Dividend. But the evidence shows that it was precisely the scenario they had in mind when they paid the May Dividend in order then to be able to sell the company and move the risk out of the group. The transaction was undertaken with the intention of putting assets beyond the reach of BAT in the event that the Maris Policy and the Historic Insurance Policies receipts were not enough to meet the indemnity claim. This prejudiced BAT because, as Mr Martinet and Mr Courteault knew, the new owners of AWA would not have any other funds to make good any shortfall.
>
> 519. I therefore find that AWA, through its directors, did have the s 423 purpose when paying the May Dividend."

73. Sequana's challenge to these findings was put in two ways. First, the judge conflated the purpose of Sequana with that of AWA and, second, she conflated the purpose of the sale of AWA with the purpose of the May dividend. Mr Rabinowitz submitted that the judge focused only on the purpose of Sequana, citing for example [511]. Sequana's aim, of insulating itself from the risk that AWA's assets would prove insufficient to meet its indemnity liabilities, could be achieved only by a sale of AWA, because of its policy of standing by its subsidiaries, but, as he correctly submitted, Sequana's purpose in selling AWA was not the relevant purpose for section 423(3). Sequana's decision to sell AWA was a different decision taken by different directors on behalf of a different company from AWA's decision to pay the dividend. It was submitted that the Judge's only finding as to AWA's purpose in paying the dividend was to eliminate the Sequana debt but that does not amount to a finding that AWA had the purpose required by section 423(3) because it neither says nor entails that the purpose was to put assets beyond the reach of BAT. Whatever Sequana's purpose in selling AWA, it could not colour AWA's purpose in the different transaction of paying the May dividend.

74. In my judgment, in the passages quoted above, the Judge made clear findings as to the purpose of AWA in resolving to pay the May dividend and in paying it by way of set-off against the Sequana debt, and that its purpose fell within section 423. The purpose was to eliminate the risk that Sequana would be responsible for AWA's liabilities if the Maris policy and the historic insurance policies proved to be inadequate. That risk could be eliminated only if two steps were taken: elimination of the Sequana debt,

thereby ending any legal obligation on the part of Sequana, and a disposal of AWA, thereby ending any moral obligation stemming from Sequana's policy of supporting its subsidiaries. The elimination of the Sequana debt removed the legal risk by removing the debt as an asset of AWA and so putting it beyond the reach of those who might make claims against AWA. That is precisely what the judge found, for example at [516]:

> "Here there is no doubt that the subjective intention of the directors at the time of the May Dividend and the sale was to prevent claims. After the declaration of the dividend and the sale to TMW, the creditors were prejudiced because the assets of AWA had been depleted and it no longer had any call on Sequana to that extent."

75. I would dismiss this ground of appeal.

Section 423: remedies

76. In addition to appealing against the Judge's rulings on liability, Sequana also appeals against the remedies provided in the Judge's order. At this stage, it is enough to say that the Judge ordered Sequana to pay to BTI (as assignee of BAT's claim as a "victim" of the payment of the May dividend) (i) the sum of US$138.4 million by way of reimbursement of sums already paid by BAT and API towards the remediation of the Lower Fox River pursuant to the Funding Agreement (to which I refer below) and (ii) such further sums up to the amount of the May dividend plus interest as BAT or API might be required to pay in respect of future clean-up costs of the Lower Fox River and other sites.

77. The Judge gave her reasons for the orders made by her in a further judgment (the Remedies judgment) handed down on 10 February 2017, after more than two days of submissions: [2017] EWHC 211 (Ch).

78. Sequana's first ground of appeal against the terms of this remedy is that the amount payable by Sequana should be restricted to the maximum liability of AWA under the Funding Agreement.

79. Until April 2012, AWA paid large sums, in excess of US$156 million, towards clean-up costs of the Lower Fox river and defence costs in US proceedings. In April 2012, AWA told NCR and API that it would not make any further payments. AWA denied that it had any liability to BAT and, while it accepted that it had provided an indemnity in favour of API in respect of its liabilities (if any) to NCR, it denied, as did API, that API had any liability to NCR. This led to extensive litigation between these four companies, which was settled by the Funding Agreement made on 30 September 2014. As regards AWA, it provides for it to have the following obligations. First, it would pay US$10 million as a contribution to NCR's past clean-up costs. Second, it had future payment obligations of an unascertained amount but subject to the condition that no amount was payable if AWA's assets were less than US$25 million or to the extent that the payment would reduce its assets to less than US$25 million. There are extensive provisions as regards the rights and liabilities of the other parties between themselves. The agreement also provides that any recoveries under the present claim under section 423, which had been commenced in December

2013, were to be paid to BTI and applied by it towards clean-up costs of the Lower Fox River.

80. Sequana submitted to the Judge, as it does before us, that the appropriate remedy under section 423 was to restore the Sequana debt that was reduced by the set-off of the May dividend. This would restore the position to that existing before the May dividend and would recognise the extent of AWA's liability to BAT (or BTI) under the Funding Agreement and hence the extent to which BAT is in fact a victim of the May dividend, the relevant time for determining that question being the date of the order. Sequana relied on the judgment of Sales J (as he then was) in *4Eng Ltd v Harper* [2009] EWHC 2633 (Ch) who said at [9] that a claim under section 423 was "a claim for some appropriate form of restorative remedy, to restore property to the transferor for the benefit of creditors, who may then seek to execute against that property in respect of obligations owed by the transferor to them". Sequana submitted that, given that AWA had disputed any liability to BAT whether directly or indirectly through the indemnity given to API, AWA's obligations under the Funding Agreement represented the best estimation by the parties of the relative value of the claims as amongst them, and is therefore the correct measure of what is fair to restore to BAT.

81. The Judge found that the Funding Agreement was the conclusion of negotiations that "took place against the background that AWA was no longer part of the Sequana group and was threatened with insolvency if pursued to meet liabilities which turned out to be greater than the sums left in the Maris Policy and generated by the Historic Insurance Polices". The terms were agreed by the parties "given the situation in which they were placed as a result, in part, of the payment of the May dividend".

82. She said of the reliance on *4Eng Ltd v Harper*, at [39] of the Remedies judgment:

> "I do not read Sales J's judgment in *4Eng* as indicating that the remedy under section 423 cannot go further than the value of any obligations of the transferor to the victims at the time when the court comes to consider the imposition of the remedy. Such a principle would risk creating an unfairness to the victims where, as here, a substantial period of time has elapsed between the date of the impugned transaction and the date when the remedy is devised and where the relationship between the various parties has changed in ways which have, at the least, been influenced by the fact that the impugned transaction took place. The *4Eng* judgment was not intended to limit the exercise of the court's discretion in the way suggested. Such a conclusion would be inconsistent with the passages in that judgment and in the other case law referring to the need for the relief to be carefully tailored to the justice of the particular case and to the absence of any 'hard and fast rules' that might impede a just result."

83. The judge referred to the provisions of the Funding Agreement dealing with recoveries under the section 423 claim, and said at [44]:

> "It seems to me therefore that the mechanism proposed by Sequana would thwart the intentions of the parties to the Funding Agreement. That intention was that anything recovered from Sequana as a result of these proceedings would go straight into the pot held by BTI in order to pay for the clean up and that that would be in addition to the other liabilities of the parties to the Agreement. A remedy under which no monies are in fact paid, but rather a debt is reconstituted and the call down of the debt is limited to AWA's three liabilities, undermines the bargain that the parties struck as a pragmatic solution to the predicament they found themselves in. It would bypass the possibility of there being any 'Sequana Recoveries' for the purposes of the agreement, despite the success of BAT in its claim in respect of the May Dividend. Such a result would not help restore the victims to their pre-transaction position nor protect their interests. If the May Dividend had not been paid then the inter-company debt owed by Sequana to AWA would not have been extinguished. Regardless of whether AWA would then have been sold, it would have had immediately available to it those monies to meet any demands that came in for reimbursement of the ongoing costs. There is no doubt that the Funding Agreement was negotiated in the context where AWA was outside the Sequana group and had few prospects of obtaining any more funds over future years. It is difficult to imagine that AWA's liability would have been limited to $10 million in relation to refunding the sums that had been paid out for the remediation between the date when AWA stopped making payments in April 2012 to the date of the Agreement in September 2014 if the context had been different. I find it hard to believe that the scope of AWA's responsibility for payment in respect of BAT's or API's liabilities would have been as limited as it is in fact under the Funding Agreement."

84. On this appeal, Sequana has repeated, by way of challenge to the judge's order, that it went beyond what was necessary to protect the interests of victims of the May dividend and that it should have been restricted to AWA's obligations to the victims under the Funding Agreement. It draws attention to the fact that, if AWA and API had succeeded in their defences to the claims of BAT, AWA would have been under no liability to BAT which would not therefore have been prejudiced by the May dividend. By entering into the Funding Agreement, AWA abandoned those defences and assumed obligations to BAT. By this means, BAT has effectively settled, and extinguished, the claim that it was asserting against AWA when the May dividend was paid.

85. Sequana submits that it was not open to the Judge on the evidence to find that the terms of the Funding Agreement had been influenced by the May dividend and, in any event, it was wrong in principle to rely on this factor. She did not find that, but for the May dividend, the Funding Agreement would not have been made, but only that it "might not" have been made. She gave no or insufficient weight to the fact that AWA and API gave up arguable defences to BAT's claims. The provisions of the Funding

Agreement, to which Sequana was not of course a party, dealing with recoveries under the section 423 claim, were irrelevant to the appropriate order against Sequana.

86. There would be very considerable force in Sequana's submissions if BAT's claims against AWA had been settled on terms that were wholly unconnected with the situation created by payment of the May dividend. But, the Judge made clear findings that the making of the Funding Agreement was at least in part a response to the insolvency of AWA to which the May dividend contributed. Moreover, she found at [44] that AWA's liability in respect of past clean-up costs would have been greater if the context had been different.

87. In his reply, Mr Rabinowitz accepted those findings of fact and the Judge's conclusion. He submitted nonetheless that it could not be shown that, but for the Funding Agreement, the victims of the May dividend would have been able to require payments from AWA, given the disputes over the liability of AWA to BAT and the liability of API to NCR. Any relief that gave BAT and other victims more than the amounts payable under the Funding Agreement would amount to a windfall.

88. In my judgment, Mr Rabinowitz's submission does not provide an answer, precisely because he accepts the Judge's finding that, but for the May dividend, the liability of AWA would have been greater. It is, of course, impossible to know the liability that would have been agreed and there can be no question of a trial of hypothetical issues as to the liability of AWA to BAT or of API to NCR. In these circumstances, 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 May dividend had not been paid and best protect the interests of the victims. Given her unchallenged findings and the inherent uncertainties, it is not in my judgment possible to say that her order was either contrary to principle or an order that she could not reasonably have made.

89. I would therefore reject this ground of appeal against the terms of her order.

90. A further ground of appeal against the terms of the order is that the Judge should have restricted the relief to the difference between the amount of the May dividend and the amount of an alternative dividend that could lawfully, and would in fact, have been paid. It is submitted that the court must ask itself the counter-factual question as to what would have happened if the impugned dividend had not been paid and, if the answer is that a lower dividend could and would have been paid without any purpose of prejudicing actual or potential claimants, the court should reflect that in its order.

91. Even assuming in Sequana's favour that the court would be required to take this approach if Sequana had established this counter-factual position, a point that I do not decide or express a view on, this ground faces insuperable obstacles.

92. This is not how the case was put to the Judge. The submission made to the Judge was that the court should decide only the dividend that *could* have been paid without infringing section 423. In the Remedies judgment at [53], the Judge rejected this as an appropriate approach, observing correctly that there was no hint of it in any of the authorities and saying that there was "no justification for the court stepping in to rescue the transferor and transferee from the consequences of their illegitimate transaction by investigating the amount that they could legitimately have paid away when they in fact chose to pay away a larger amount".

93. It was not part of Sequana's case in answer to the section 423 claim that AWA *would* in fact have paid a dividend of a lesser amount, and it did not adduce any evidence to establish it. Mr Rabinowitz submitted that the case should be remitted so that findings on this issue could be made. It was, however, the responsibility of Sequana to present its case at trial and there are no grounds for permitting it a second opportunity to do so.

94. In any event, as the Judge found at [53], this suggestion is entirely contrary to Sequana's own evidence, that the purpose was to eliminate the whole or virtually the whole of the Sequana debt as part of the plan to insulate Sequana from the risk of claims against AWA. Sequana's aim was to remove the risk, not reduce it.

95. Finally, Sequana challenges that part of the Judge's order that fixed rates of interest notionally applicable to the reversal of the May dividend. This is linked to a cross-appeal by BAT as to the appropriate currency conversion rate.

96. For this purpose, it is necessary to look at the detail of the Judge's order. Paragraph 2(1) ordered Sequana to pay US$138.4 million to BTI in respect of clean-up costs already paid by BAT and API. Paragraph 2(2) provided for Sequana to pay further sums in the future up to the following limit specified in paragraph 2(2)(a):

> "the amount of the May Dividend plus interest at the rate previously applied to the inter-company debt (i.e the EURIBOR overnight rate plus 0.25%) for the period 18 May 2009 to the date of issue of these proceedings (i.e 9 December 2013) and thereafter at the U.S. dollar Libor 12 month rate plus 2% to the date of this order less the Lump Sum which shall be converted to Euros at the rate of €1/US$1.27."

97. As sub-paragraph (a) states, the contractual rate of interest is taken as payable up to the date of commencement of the section 423 proceedings (9 December 2013) but the currency conversion rate of €1/US$1.27 was the market rate on 30 September 2014, the date of the Funding Agreement. A currency conversion was of course necessary because the May dividend and the Sequana debt were denominated in euros while AWA's indemnity liabilities were payable in US dollars. Both parties are agreed that the Judge was wrong to select different dates for these purposes. BAT submits that 9 December 2013 is the correct date, while Sequana submits that 30 September 2014 is the correct date. As regards interest, we were told that the choice of the earlier date results in an increased liability of over US$10 million for Sequana. As regards the currency conversion date, the Judge records in the Remedies judgment at [58] that the earlier date would work in BTI's favour to the extent of about US$50 million.

98. BAT submitted that the correct date for both purposes was 9 December 2013 as the date on which the section 423 proceedings were issued and, given that the claim was well-founded, it was therefore the date on which Sequana should have accepted liability and agreed that the Sequana debt remained outstanding. The board of AWA, acting properly, would then have called in the debt and converted the funds into US dollars. Sequana submitted that there was no reason to suppose that the reconstituted debt would or should have been called before AWA required the funds to meet a liability. That first occurred on 30 September 2014. The amount then payable was significantly less than the full amount of the Sequana debt, so that the full amount of

the debt would not necessarily have then been called, but it is prepared to accept that interest at the increased rate should be paid on the full amount from that date.

99. The Judge rejected BAT's submission on the currency conversion date because to fix 9 December 2013 as the date would result in a windfall. She held that there was an insufficient "factual basis for the counterfactual position that Mr Thompson put forward". She found that it was unlikely that, if the Sequana debt had remained in existence, AWA would have called in the whole amount as soon as it could.

100. Mr Thompson submitted that the Judge adopted the wrong approach. He did not ask us to reverse the finding of fact made by her that the board of AWA would not in fact have called in the Sequana debt in December 2013, but he submitted that, acting in accordance with its duties to AWA, the board in that situation ought to have called in the debt. I am unable to see that the board would have been in breach of its duties by waiting until payments became due from AWA under its indemnity obligations and, in those circumstances, it seems to me that the Judge was right to adopt an approach based on what the board would have been likely to do. I would dismiss BAT's cross-appeal on the currency conversion issue.

101. As regards the choice of 9 December 2013 as the date from which interest at the higher, non-contractual rate was payable, the Judge gave her reasons in the Remedies judgment at [56]:

> "But in light of the findings in the Main Judgment, Sequana should have conceded when the s 423 claim was lodged that the May Dividend was caught by section 423. Given that I have now found that an immediate payment should in principle be made in respect of past costs, Sequana ought to have offered to make a payment at that point. It follows that interest should run at the higher commercial rate from that time and I will so order."

102. Sequana submits that the Judge's reasoning cannot support her order. The "past costs" to which she refers, and which she says Sequana should have paid, were not paid by BAT until 30 September 2014 (see the Remedies judgment at [11(a)]) and could not therefore have been demanded from AWA until then.

103. BAT supports the Judge's reasoning on two grounds. First, the usual approach to an award of interest is that it should start from the date when the defendant should have accepted liability, which in this case was 9 December 2013 when the claim was issued. However, that assumes that payment should have been made on that date, but in this case an acceptance of liability would have revived the Sequana debt but, as the Judge found, it would not have been called until September 2014. Second, BAT repeats its submission made on the issue of the currency conversion date that, if the Sequana debt is treated as revived on 9 December 2013, the board should then have called it in. For the reasons already given, I have rejected that submission.

104. The choice of date from which the higher rate of interest is to run was a matter for the Judge's discretion, and this court will be very reluctant to interfere with a judge's decision on an issue such as this. However, in my view, there is no proper basis for

the choice of 9 December 2013 as the appropriate start date, and I would allow Sequana's appeal on this point.

Breach of duty: introduction

105. BTI appeals against the dismissal of its claim that payment of the May dividend was authorised by the directors of AWA in breach of their duties as directors. Such duties were owed to AWA and, as mentioned above, AWA assigned this claim to BTI which was substituted as claimant.

106. BTI submits that this claim lies even though the dividend was lawfully paid in accordance with Part 23 of the Companies Act 2006 and with no breach of the remaining common law restrictions on distributions to shareholders. BTI does not challenge the Judge's conclusions on those issues and, in particular, accepts that the provision in AWA's accounts against its indemnity liabilities was properly considered and made by the directors. The directors concluded that the likely liability of AWA was within the funds available under the Maris policy.

107. The principal element in BTI's case is that directors owe a duty to consider the interests of creditors in any case where a proposal involves a real, as opposed to a remote, risk to creditors.

108. BTI submits that this duty arose at common law but, since the relevant part of the Companies Act 2006 came into force, it arises under section 172(3). Section 172 is in Chapter 2 of Part 10, headed "General duties of directors". Sections 171 to 177 set out the general duties owed by a director to a company. The general duties "are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director": section 170(3). Section 170(4) provides: "The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties".

109. The enactment of these provisions was the culmination of a long debate over many years on the merits of a statutory codification of directors' duties. Following the recommendations of both the Law Commission and the Scottish Law Commission (Joint Report: *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*, 1999, Nos 261 and 173) and the Company Law Review Steering Group (Final Report, 2001), the Government included the codification of directors' duties in the Bill enacted as the Companies Act 2006. A statutory statement would make the law "more consistent, certain, accessible and comprehensible", so enabling directors' duties to be "widely known and understood" (White Paper Company Law Reform, 2005, Cm 6456).

110. Section 172 provides, so far as relevant:

> "(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-

> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment.
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.
>
> (2) …
>
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

111. Unlike the other, prescriptive statements of duty in sections 171-177, section 172(3) merely refers to "any…rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors" without stating the circumstances in which this requirement arises.

112. BTI submits that the duty under section 172(3) was engaged because a real, as opposed to a remote, risk to BAT as a creditor was self-evidently involved in the payment of the May dividend.

113. AWA was not carrying on any business. Its only function by the end of 2008 was to run off its indemnity liability, in much the same way as an insurer in run-off. For this purpose, it had three assets available to it: the Maris policy, under which $162.4 million remained available as at 31 December 2008, the historic insurance policies and the Sequana debt. The effect of the May dividend was to reduce that debt from about €138.2 million to €3.1 million, and so by that amount to reduce the assets available to meet the indemnity liability. After taking account of the provision and the funds under the Maris policy, the balance sheet of AWA showed net assets of about €3 million but this did not take into account potential recoveries under the historic insurance policies.

114. While the estimate of the indemnity liability was made by the directors fully in compliance with their statutory duties and in compliance with the applicable accounting standards, it was not in doubt that the estimate could in the future prove to have been too small or, indeed, too large. It was to guard against the estimate being too large that Sequana insisted on a right under the terms of the sale of AWA to share in any future upside. Equally, it was understood by all concerned that the estimate could prove to be too low. As Sequana's board minutes for the meeting on 27 May 2009 recorded, it was "a significant underlying risk that was difficult to control".

115. This uncertainty was reflected in the "emphasis of matter" statement in the audit report of PwC for the final accounts for 2008. It stated:

> "Without qualifying our opinion we draw attention to note 15 to the financial statements, which describes how the Company has indemnified a former subsidiary company, Appleton Papers Inc, for costs in connection with the costs of investigation, remediation of and other costs related to the alleged contamination of the Lower Fox River in Wisconsin, USA. The valuation of this liability and its settlement date, together with the realisation of potential contingent insurance policy assets, involve significant judgements by the Company. While the Directors have carried out an assessment of the position at 31 December 2008, this matter will still depend on the rulings of court cases and other agreements with relevant other parties in the future, the outcome of which are not certain at the date of these financial statements, nor necessarily under the control of the Company."

116. An emphasis of matter statement derives from International Standard on Auditing (UK and Ireland) 700. It does not affect the auditor's opinion that the accounts have been properly prepared in accordance with the applicable legislation and give a true and fair view of the company's affairs at the year end, but it describes "the matter giving rise to the significant uncertainty and its possible effects on the financial statements". Paragraph 32-4 of ISA 700 states:

> "32-4. Uncertainties are regarded as significant when they involve a significant level of concern about the validity of the going concern basis or other matters whose potential effect on the financial statements is unusually great. A common example of a significant uncertainty is the outcome of major litigation."

117. The ultimate liability of AWA depended on a large number of what the Judge called "moving parts", including several pieces of large-scale litigation in the United States. Adverse changes could result, as all appreciated, in a deterioration in AWA's exposure that might not be absorbed by recoveries under the historic insurance policies.

Breach of duty: the judgment below

118. The Judge referred, as I will, to the relevant duty as "the creditors' interests duty".

119. At [460]-[463], she recorded some points of common ground between the parties. First, the effect of section 172(3) was to retain the common law principles as to when the duty arises. Second, the duty is owed to the company, not to creditors. Third, there is a single threshold for when the duty arises for all decisions taken by directors. There is not a separate duty in the case of a proposed dividend, although "BTI do say that the fact that the decision in dispute here is a decision to pay a dividend, rather than any other kind of decision about the future of the business, is significant because it is a decision that benefits only the interests of the shareholder and not at all the interests of the creditors". Fourth, the content of the duty does not vary according to

the degree of risk of insolvency. Fifth, a failure to have regard to the interests of creditors is not of itself a breach of duty, if the directors could have reasonably concluded that the proposal should be approved even if creditors' interests were taken into account.

120. At [464], the Judge further recorded that Sequana and the other defendants accepted that the duty could arise in circumstances where the company was not actually insolvent. "Something short of actual insolvency is sufficient. The question is, how close to insolvency does the company have to be? The Defendants argue that it has to be very close to insolvency, the Claimants contend that it is enough if there is a real, as opposed to a remote, risk of insolvency."

121. The Judge reviewed many of the authorities cited to her. Having done so, she said at [477]:

> "To say that my house is on the verge of burning down seems to me to describe a much more worrying situation compared to one in which there is a risk which is something more than a remote risk of my house burning down. Similarly, giving the words their natural meaning, a test set at the level of 'a real (as opposed) to remote risk of insolvency' would appear to set a much lower threshold than a test set at the level of being 'on the verge of insolvency' or of 'doubtful' or 'marginal' solvency. But I agree with the conclusion of Mr Randall QC in *HLC Environmental* that the authorities appear to treat these and all the other formulations as different expressions of the same test. Having reviewed the authorities I do not accept that they establish that whenever a company is 'at risk' of becoming insolvent at some indefinite point in the future, then the creditors' interests duty arises unless that risk can be described as 'remote'. That is not what the cases say and there is no case where, on the facts, the company could not also be accurately described in much more pessimistic terms, as actually insolvent or 'on the verge of insolvency', 'precarious', 'in a parlous financial state' etc."

122. At [478] the Judge said that this case was very different from the other cases in which the triggering of the duty had been considered: "AWA's balance sheet showed no deficit of liabilities over assets and there were no unpaid creditors knocking at AWA's door. It was not in the downward spiral of accumulating trading losses, with no income and no prospect of any income that is typical of the companies where the duty has been held to have arisen." By contrast, looking at the circumstances of AWA, she said at [479]:

> "It cannot be right that whenever a company has on its balance sheet a provision in respect of a long term liability which might turn out to be larger than the provision made, the creditors' interests duty applies for the whole period during which there is a risk that there will be insufficient assets to meet that liability. That would result in directors having to take account of creditors' rather than shareholders' interests when running a

> business over an extended period. This would be a significant inroad into the normal application of directors' duties. To hold that the creditors' interests duty arises in a situation where the directors make proper provision for a liability in the company's accounts but where there is a real risk that that provision will turn out to be inadequate would be a significant lowering of the threshold as currently described and applied in the cases to which I have referred. I can see no justification in principle for such a change."

123. The Judge therefore concluded at [483]:

> "Taking all these factors into account, I do not think that AWA could be described as on the verge of insolvency or of doubtful insolvency [sic], or as being in a precarious or parlous financial state. The risk it faced that the best estimate would turn out to be wrong and that the company might not have enough money, when called upon in the future, is a risk that faces many companies that have provisions and contingent liabilities reflected in their accounts. It is not enough in my judgment to create a situation where the directors are required to run the company in the interests of the creditors rather than the shareholders of the company."

124. The Judge accordingly held that the creditors' interests duty had not arisen at the time of the directors' decision to pay the May dividend.

Breach of duty: the authorities

125. Companies registered under the Companies Acts are the principal medium through which business is carried on in this country. Businesses are for the most part carried on for the purpose of making profits for their shareholders and business involves risk-taking, as all who deal with them know (or should know).

126. Registered companies must have one or more directors and it is their function, subject to the provisions of the company's articles of association, to carry on the business of the company. They do so ultimately for the benefit of the shareholders, who have the power to appoint and remove directors. It is well established that the shareholders may authorise or subsequently ratify any *intra vires* act or omission of the directors so as to make lawful what would otherwise be a breach of duty on their part. This is consistent with the basic principle that the interests of the company are identified with the interests of the shareholders as the owners of the company.

127. In the context of companies that are normally and necessarily risk-taking, this primacy of the interests of shareholders involves risks for those dealing with companies, in particular creditors. To a large extent, those risks come with the fact of dealing with the company, and in the case of most creditors they are voluntarily assumed (as they were in the present case when indemnities were taken from AWA). Creditors can be assumed to look after their own interests when deciding to deal with a company and there are a range of protective measures, such as the taking of security, for which they can bargain.

128. This approach has never been considered a complete answer to the issue of protection of the interests of creditors. There has been statutory intervention in two main respects. First, insolvency legislation has for many years contained provisions for setting aside transactions which have prejudiced creditors. For the most part, these apply as much to individual debtors as they do to insolvent companies, a recognition that dealing with individuals may be as risky as dealing with companies. In the case of companies, personal liabilities for fraudulent trading and for wrongful trading are imposed on directors. Second, companies legislation contains provisions to protect creditors. These include the prohibition on the return of capital to shareholders except through one of the authorised means, the restrictions on the payment of dividends now contained in Part 23 and the various protections applicable to the purchase or redemption by a company of its own shares. It is to be noted that in the present case, BAT as a creditor prejudiced by the May dividend has obtained substantial relief under section 423.

129. Any recognition at common law that consideration of the interests of creditors could in certain circumstances be an element in the duties of directors is remarkably recent. Its first appearance, so far as appears from the many authorities cited to us, was in the decision of the High Court of Australia in *Walker v Wimborne* [1975-1976] 137 CLR 1. Like most of the authorities to which we were referred, this bears out the Judge's observation which I quote below that statements must be read in the context of the facts of the case.

130. The facts in *Walker v Wimborne* were that an informal "group" of companies had common directors. They adopted a policy of moving funds between these companies, as circumstances required. One company (Asiatic) lent $10,000 to another company (Australian Sound), funded by a loan of $10,000 by a third company (Estoril), the repayment of which was secured by an equitable mortgage. The resulting debt from Australian Sound was unsecured and there was no suggestion that Asiatic received any benefit from the loan. At the time both Asiatic and Australian Sound were insolvent and indeed at that time Asiatic had been served with a demand for payment of a longstanding judgment debt on which the order to wind up Asiatic was subsequently based. By a majority (Barwick CJ and Mason J, Jacobs J dissenting) the High Court reversed the decision at first instance of Street CJ and held that the payment to Australian Sound was a breach of duty by the directors of Asiatic responsible for it.

131. Giving the principal majority judgment, Mason J said that there were no interlocking shareholdings between the companies and that Asiatic derived no benefit if Australian Sound succeeded in staving off liquidation and suffered no loss if it went into liquidation. He continued at pp. 6-7:

> "Indeed, the emphasis given by the primary judge to the circumstance that the group derived a benefit from the transaction tended to obscure the fundamental principles that each of the companies was a separate and independent legal entity, and that it was the duty of the directors of Asiatic to consult its interests and its interests alone in deciding whether payments should be made to other companies. In this respect it should be emphasized that the directors of a company in discharging their duty to the company must take account of the

> interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of a company, whether it be a member of a "group" of companies in the accepted sense of that term or not, must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent."

132. This statement of principle was made in the context of the insolvency of Asiatic, and Australian Sound, at the time of the transfer of $10,000. It was because of their insolvency that the failure to take into account the interests of creditors "will have adverse consequences for the company as well as for them". If Asiatic had been solvent, any breach of duty by the directors in disregarding the separate interests of Asiatic could have been ratified by the shareholders.

133. The first appearance of a duty to have regard to the interests of creditors in the English authorities was in *obiter dicta* of Templeman LJ in *Re Horsley & Weight Ltd* [1982] Ch 442. In that case, a solvent company made a lump sum payment for a pension policy for a retiring director. The company subsequently became insolvent and went into compulsory liquidation. The liquidator's claim that the payment was *ultra vires* as being outside the company's objects failed at first instance and on appeal, as did his claim that the payment was in any event a misfeasance. The payment had been made with the knowledge and unanimous consent of the shareholders.

134. In his judgment, Templeman LJ said at p. 455:

> "There remains the question whether the grant of the pension was in the circumstances a misfeasance committed by the two directors who procured the grant and by the respondent, the director who accepted the grant. If the company had been doubtfully solvent at the date of the grant to the knowledge of the directors, the grant would have been both a misfeasance and a fraud on the creditors for which the directors would remain liable. But the good faith of the directors is not impugned.
>
> In the absence of fraud there could still have been negligence on the part of the directors. If the company could not afford to spend £10,000 on the grant of a pension, having regard to problems of cash-flow and profitability, it was negligent of the directors to pay out £10,000 for the benefit of the respondent at that juncture. There could have been gross negligence, amounting to misfeasance. If the company could not afford to pay out £10,000 and was doubtfully solvent so that the expenditure threatened the continued existence of the company, the directors ought to have known the facts and ought at any rate to have postponed the grant of the pension until the financial position of the company was assured.

> The findings of the judge are sufficient to support the suspicion that the company could not afford to pay out £10,000 for the benefit of the respondent, but this suspicion is largely based on hindsight. The accounts show that business was expanding, that there were no discernible cash-flow problems and that past profits were sufficient to absorb half of the payment for the pension, leaving the other half to be absorbed in the future. There seemed to be every indication that with the profits anticipated, and the possibility of reducing directors' salaries if necessary, the remainder of the payment for the pension could be absorbed by the company. In these circumstances it is difficult to convict the directors of negligence. It is impossible to convict them of gross negligence amounting to misfeasance because the allegation was never clearly levied, the directors were not even accused by the liquidator and did not give evidence, and the judge therefore made no sufficient finding."

135. It is unnecessary to consider whether the distinction there drawn by Templeman LJ between negligence and gross negligence is now supportable, but it can be seen that the essential criterion for the theoretical breach of duty that he was discussing would arise if "the company could not afford to pay out £10,000 and was doubtfully solvent so that the expenditure threatened the continued existence of the company", in which event the directors ought at any rate to postpone the payment until the financial position of the company was assured.

136. In a short judgment, Cumming-Bruce LJ considered that a breach of duty would be committed if "the directors should at the time have appreciated that the payment was likely to cause loss to creditors".

137. There was further consideration of the relevance of creditors' interests in the exercise by directors of their powers in cases in Australia and New Zealand decided after *Walker v Wimborne*, but I will start with the only authority binding on us, the decision of this court in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250 (*West Mercia*).

138. The defendant Mr Dodd was a director of AJ Dodd & Co Limited and of its wholly-owned subsidiary, West Mercia Safetywear Limited. The holding company's bank overdraft was personally guaranteed by Mr Dodd and it was owed about £30,000 by the subsidiary, whose bank account was in credit. In May 1984, both companies were insolvent and the directors engaged an accountant to advise them and to take the steps necessary to put the companies in liquidation. The accountant explained very clearly to Mr Dodd and his fellow director that they should not operate the companies' bank accounts. On 21 May 1984, after the advice had been given, Mr Dodd caused £4,000 to be transferred from the subsidiary's account to the holding company's account. Both companies went into liquidation on 4 June 1984.

139. The liquidator brought proceedings against Mr Dodd to recover £4,000 and interest. The trial judge found that the plain and obvious intention in making the transfer was to reduce the overdraft and hence Mr Dodd's personal liability as guarantor. This was therefore a "fraudulent preference" and a breach of duty on the part of Mr Dodd. However, the trial judge dismissed the claim, partly in reliance on comments in this

court's decision in *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

140. As to that, Dillon LJ (with whom the other members of the court agreed) said at p.252:

> "The *Multinational* case was, however, a wholly different case from the present. In the present case the West Mercia company was at the relevant time insolvent to the knowledge of the directors. They had been expressly told not to deal with the company's bank account, and Mr Dodd had, in fraud of the creditors of the company, made the transfer to the Dodd company's account for his own sole benefit in relieving his own personal liability under his guarantee. In the *Multinational* case, at the time of the transaction which was in question, the company concerned was amply solvent, and what the directors had done at the bidding of the shareholders had merely been to make a business decision in good faith, and act on that decision. It subsequently turned out to be a bad decision, but the position had to be decided on the facts at the earlier stage, where the company was amply solvent and the parties were acting in good faith."

141. Dillon LJ concluded that Mr Dodd was guilty of breach of duty when for his own purposes he made the transfer "in disregard of the interests of the general creditors of this insolvent company".

142. In reaching this conclusion, Dillon LJ said that he had found helpful and would approve the following statement of Street CJ in *Kinsela v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722 (*Kinsela*) at 730:

> "In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."

143. This court's decision in *West Mercia* establishes two propositions. First, the shareholders of an insolvent company cannot ratify the acts of directors taken in disregard of the interests of creditors, and, as a necessary corollary, it is incumbent on the directors of an insolvent company to have regard to those interests. Second, the

rationale is that, because of the company's insolvency, its assets are in a practical sense the assets of the creditors, pending its liquidation or return to solvency.

144. *Kinsela* likewise concerned a company that was insolvent. A lease made by the company in favour of the directors at a rent substantially below market rates was held to have been made in breach of duty by the directors and was avoided. The directors' defence was that between them they owned all the shares and the lease was therefore made with the unanimous consent of the shareholders, thereby ratifying the directors' act in granting it. For the reasons given by Street CJ in the passage cited by Dillon LJ, the Court of Appeal of New South Wales held that there could be no effective ratification. Indeed, the grant of the lease had the hallmarks of a transaction in fraud of creditors, Street CJ saying at p. 727: "this insolvent company, in a state of imminent and foreseen collapse, entered into a transaction which plainly had the effect, and was intended to have the effect, of placing its assets beyond the immediate reach of its creditors".

145. However, it is arguable that Street CJ went further in a lengthy passage in which he cited with approval the judgment of Cooke J in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242 (*Permakraft*), a decision of the New Zealand Court of Appeal. The facts of *Permakraft* may be summarised as follows. The company, a furniture manufacturer, although profitable in most years, was under-capitalised and experienced liquidity problems. To address this, the shareholders unanimously approved a restructuring, involving a new holding company to which they provided $160,000 equity capital and which raised further funds by way of borrowing. The holding company purchased the company's land and buildings for more than their book value, giving rise to a profit which was distributed to the shareholders as a dividend. The holding company leased the land and buildings back to the company which, by reason of its increased costs caused by the rent payable by it, was entitled to increase its selling prices under price control legislation. All trade debts were paid and the company's unaudited accounts showed a net profit for the year. It encountered further difficulties and made a loss in the following year, leading to its receivership and subsequent liquidation.

146. The liquidator brought proceedings to recover from the directors the amount of the dividend. The claim succeeded at first instance, save that the judge excused two directors under the New Zealand equivalent of section 1157 of the Companies Act 2006. The other directors appealed. The judge found that all the directors had acted honestly and had no intention to remove assets from the reach of creditors, but he also found that they had no regard for the position of the company itself, as opposed to the group comprising also the holding company and the shareholders. The appeal was allowed on the basis that the evidence did not justify this latter finding and that the decision to approve and implement the restructuring, including payment of the dividend, could not be dismissed as unreasonable or as likely to cause loss to creditors.

147. In the course of his judgment, Cooke J analysed the duties of directors as regards the interests of creditors. At pp. 249-250, he said:

> "The duties of directors are owed to the company. On the facts of particular cases this may require the directors to consider inter alia the interests of creditors. For instance creditors are

> entitled to consideration, in my opinion, if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency.
>
> The criterion should not be simply whether the step will leave a state of ultimate solvency according to the balance sheet, in that total assets will exceed total liabilities. Nor should it be decisive that on the balance sheet the subscribed capital will remain intact, so that a capital dividend can be paid without returning capital to shareholders. Balance sheet solvency and the ability to pay a capital dividend are certainly important factors tending to justify proposed action. But as a matter of business ethics it is appropriate for directors to consider also whether what they do will prejudice their company's practical ability to discharge promptly debts owed to current and likely continuing trade creditors.

To translate this into a legal obligation accords with the now pervasive concepts of duty to a neighbour and the linking of power with obligation. It is also consistent with the spirit of what Lord Haldane said [in *Attorney-General for Canada v Standard Trust Company of New York* [1911] AC 498 at 503-505]. In a situation of marginal commercial solvency such creditors may fairly be seen as beneficially interested in the company or contingently so.

On the other hand, to make out a duty to future *new* creditors would be much more difficult. Those minded to commence trading with and give credit to a limited liability company do so on the footing that its subscribed capital has not been returned to the shareholders, but otherwise they must normally take the company as it is when they elect to do business with it. Short of fraud they must be the guardians of their own interests.

In the case of a supplier who already has an established trade relationship with a company, there is of course a distinction between current and future debts. It seems to me neither necessary nor desirable, however, to use that distinction so as to limit the duties of the directors of the debtor company to considering whether debts already incurred can be paid. If the company's financial position is precarious the fortunes of such suppliers may be so linked with those of the company as to bring them within the reasonable scope of the directors' duties. They may continue to give credit in ignorance of a change damaging to their prospects of payment.

The recognition of duties to creditors, restricted as already outlined, is justified by the concept that limited liability is a privilege. It is a privilege healthy as tending to the expansion of opportunities and commerce; but it is open to abuse. Irresponsible structural engineering – involving the creating, dissolving or transforming of incorporated companies to the prejudice of creditors – is a mischief

> to which the Courts should be alive. But a balance has to be struck. There is no good reason for cultivating a paternal concern to protect business people perfectly able to look after themselves.
>
> For those reasons, among the many authorities cited to us I would respectfully adopt the approach of Cumming-Bruce and Templeman LJJ in *Re Horsley & Weight Ltd* [1982] Ch 442, 454-456. Both Lord Justices favoured an objective test: whether at the time of the payment in question the directors "should have appreciated" or "ought to have known" that it was likely to cause loss to creditors or threatened the continued existence of the company. In my opinion, a payment made to the prejudice of current or continuing creditors when a likelihood of a loss to them ought to have been known is capable of constituting misfeasance by the directors; and they may be made liable for it in an action of the present kind. Alternatively an application may be made under s 321 of the Companies Act, which in the substituted form enacted in 1980 extends to "any negligence, default, or breach of duty or trust in relation to the company".
>
> I also share the view to which Cumming-Bruce and Templeman LJJ evidently inclined in their obiter observations that in such cases the unanimous assent of the shareholders is not enough to justify the breach of duty to the creditors. The situation is really one where those conducting the affairs of the company owe a duty to creditors. Concurrence by the shareholders prevents any complaint by them, but compounds rather than excuses the breach as against the creditors".

148. It is this passage, or part of it, that Street CJ cited in *Kinsela*.

149. There are some parts of this passage which, on any view, are difficult. First, there are repeated references to a duty owed by directors to creditors. Coupled with the reference to "the now pervasive concepts of duty to a neighbour" (perhaps more pervasive then than now), this may suggest a direct duty to certain categories of creditors, identified by Cooke J as present creditors and likely continuing trade creditors, enforceable by those creditors. Although the existence of such a duty was discussed, mainly in academic writings, it gained no authority in decided cases and is now ruled out by the clear statement in section 170(1) that the general duties of a director are owed to the company. Reading the judgment as a whole, I take the view that Cooke J was discussing a duty of the directors to have regard to the interests of creditors in certain circumstances, not a duty directly enforceable by creditors against directors. It follows that his reference to "a duty to future new creditors" was intended to exclude them from a consideration of whether, at the time of the directors' decision, the company was likely to become insolvent. This, however, may itself cause confusion. Once it is established that directors are in certain circumstances under a duty to have regard to the interests of creditors, a breach of that duty will entitle the company to recover compensation for the loss caused to the company, which will not be limited to the loss indirectly caused only to present creditors or present and likely future trade creditors.

150. Second, the rationale adopted by Cooke J has a number of entirely separate strands. He identified, as did Street CJ in Kinsela and Dillon LJ in *West Mercia*, that in certain circumstances creditors "may fairly be seen as beneficially interested in the company or contingently so". But, he also appealed to "business ethics", a quite different and more elastic point of reference. He added also that a recognition of duties to creditors was "justified by the concept that limited liability is a privilege".

151. Cooke J is by no means alone among judges in describing limited liability as a privilege. With respect, this is, in my view, a mistaken approach. In English law, the right to form and a register a company under the Companies Act is, in no sense, a privilege. It is a right conferred by statute in unqualified terms, and it is a right that Parliament created over 170 years ago in the public interest and for the purpose of advancing the economic well-being of the country. In any event, the right is conferred on those who form a company, the shareholders, while the duty under discussion is one imposed on directors who, as in the present case, may well not be the shareholders.

152. Having said this, the key passages in Cooke J's judgment are, in my view, as follows. He said that creditors were entitled to consideration "if the company is insolvent, or near-insolvent, or of doubtful solvency, or if a contemplated payment or other course of action would jeopardise its solvency". He relied in particular on *dicta* in *Re Horsley & Weight Ltd* for the proposition that "a payment made to the prejudice of current or continuing creditors when a likelihood of loss to them ought to have been known is capable of constituting misfeasance by the directors". At p. 252, he repeated his "adherence to the objective test whether the directors ought to have realised that their action was likely to cause loss to existing and continuing creditors".

153. These views of Cooke J were not endorsed by the other members of the court sitting with him. Richardson J held that the evidence did not justify a finding that the company was at the time of the dividend near to insolvency and allowed the appeal on that basis. In those circumstances, he said at p.254, "I prefer to reserve to another day the controversial question of the nature and scope of the duties owed by directors and shareholders to creditors of the company". At p. 255, he said:

> "Turning now to the wider legal issue, the traditional view has been that apart from statutory obligations to take into account the interests of creditors (in particular s 320 and also ss 311B, 311C, 315A, 315B, 315C and 364 of the Companies Act 1955) and the general obligation to maintain the company's capital, directors are not required to have regard to the interests of creditors in exercising their responsibilities: their concern is with the financial interests of the shareholders. In recent years a wider view of directors' responsibilities has been expressed in some of the cases in a number of common law jurisdictions (see (1984) 11 NZULR 68). If this Court is to move in that direction its decision to do so would need to be based on a thorough examination of the scheme and purpose of the companies' legislation. I prefer to leave that for a case where this question, itself a difficult amalgam of principle, policy, precedent and pragmatism, must be decided."

154. A similar approach was taken by Somers J who said at pp. 255-256:

> "In the case of an insolvent company, at least in the sense that its liabilities exceed its assets, directors in the management of a company must have regard to the interests of creditors. That is because according to the order of application of assets on a winding up they are trading with the creditors' money. It has been suggested that when the solvency of a company is doubtful or marginal it will be a misfeasance (probably not capable of being ratified or exonerated by shareholders) to enter into a transaction which directors ought to know is likely to cause a loss to creditors – see eg *Re Horsley & Weight Ltd* [1982] Ch 442, 455 per Cumming-Bruce LJ, and Templeman LJ. Whether that is so does not in my view fall to be decided now for in the instant case I am satisfied the company was solvent at the material times."

155. Returning to *Kinsela*, Street CJ cited the passages above from the judgments of Richardson and Somers JJ and then stated at pp. 732-733:

> "It is, to my mind, legally and logically acceptable to recognise that, where directors are involved in a breach of their duty to the company affecting the interests of shareholders, then shareholders can either authorise that breach in prospect or ratify it in retrospect. Where, however, the interests at risk are those of creditors I see no reason in law or in logic to recognise that the shareholders can authorise the breach. Once it is accepted, as in my view it must be, that the directors' duty to a company as a whole extends in an insolvency context to not prejudicing the interests of creditors (*Nicholson v Permakraft (NZ) Ltd* and *Walker v Wimborne*) the shareholders do not have the power or authority to absolve the directors from that breach.
>
> I hesitate to attempt to formulate a general test of the degree of financial instability which would impose upon directors an obligation to consider the interests of creditors. For present purposes, it is not necessary to draw upon *Nicholson v Permakraft* as authority for any more than the proposition that the duty arises when a company is insolvent inasmuch as it is the creditors' money which is at risk, in contrast to the shareholders' proprietary interests. It needs to be borne in mind that to some extent the degree of financial instability and the degree of risk to the creditors are inter-related. Courts have traditionally and properly been cautious indeed in entering boardrooms and pronouncing upon the commercial justification of particular executive decisions. Wholly differing value considerations might enter into an adjudication upon the justification for a particular decision by a speculative mining company of doubtful stability on the one hand, and, on the other hand, by a company engaged in a more conservative business in a state of comparable financial instability. Moreover, the plainer it is that it is the creditors' money that is at risk, the lower may be the risk to which the directors, regardless of

> the unanimous support of all of the shareholders, can justifiably expose the company.
>
> The foregoing, and like, considerations point to the desirability of avoiding an attempt to enunciate principles in wide-ranging terms. Having said that, however, I reiterate my own respectful agreement with the passage in the judgment of Cooke J (at 457-460) to which I have already referred."

156. The other members of the New South Wales Court of Appeal, Hope JA and McHugh JA, agreed with the orders proposed by Street CJ and with his reasons. As the ratio of Street CJ's judgment was that the company was insolvent and that for the purposes of the case before the court "it is not necessary to draw upon *Nicholson v Permakraft* as authority for any more than the proposition that the duty arises when a company is insolvent inasmuch as it is the creditors' money which is at risk, in contrast to the shareholders' proprietary interests", the other members of the court cannot be read as concurring in Street CJ's endorsement of the *obiter* views of Cooke J in *Permakraft*, as Mr Thompson accepted.

157. The position as I see it following these cases is that Cooke J in New Zealand and Street CJ in New South Wales had expressed *obiter* views that the duty to have regard to the interests of creditors could arise in circumstances short of actual insolvency. Such circumstances did not exist in either case because the company in *Permakraft* was at the relevant time solvent and the company in *Kinsela* was insolvent. Likewise, such circumstances did not exist in *West Mercia*, where the company was insolvent. Dillon LJ did not cite or endorse the *obiter* views expressed by Cooke J and Street CJ.

158. I have set out the relevant passages from these cases at length because they have to a significant extent defined the discussion of the creditors' interests duty in subsequent cases and in the submissions made in the present case.

159. Before looking at the later cases in which this issue has been discussed, I should mention a case in this court on which Mr Thompson placed some reliance. *Brady v Brady* [1988] BCLC 20 concerned a complex corporate restructuring which was challenged on the grounds, among others, that it constituted unlawful financial assistance by a company for the purpose of an acquisition of its shares, contrary to section 151 of the Companies Act 1985. In response, reliance was placed on section 153 which applied if, *inter alia*, "the assistance was given in good faith in the interests of the company". At p. 40, Nourse LJ said:

> "The interests of a company, an artificial person, cannot be distinguished from the interests of the persons who are interested in it. Who are those persons? Where a company is both going and solvent, first and foremost come the shareholders, present and no doubt future as well. How material are the interests of creditors in such a case? Admittedly existing creditors are interested in the assets of the company as the only source for the satisfaction of their debts. But in a case where the assets are enormous and the debts minimal it is reasonable to suppose that the interests of the creditors ought not to count for very much. Conversely, where

> the company is insolvent, or even doubtfully solvent, the interests of the company are in reality the interests of existing creditors alone."

160. That passage is, subject to the addition of "even doubtfully solvent", consistent in scope and rationale with Dillon LJ in *West Mercia*. However, Nourse LJ went on to say:

> "What is accepted here is that Brady remained solvent after the dispositions had taken place and also that they were made in good faith, that is to say without any positive intention to defraud creditors. But there is no evidence which shows that the interests of creditors were ever considered. The directors never asked themselves whether *half* the assets would *in all eventualities* be sufficient to discharge *all* the existing debts. The proportion of the assets being removed was so large as to make it essential for that question to be asked. Since it was not asked it cannot in my view be said, for the purposes of an exception to the provisions of sec. 151, that the directors considered that the dispositions were in the interests of the two companies. The most which can be said is that they considered that they were in the interests of the shareholders."

161. Mr Thompson commented that this was a demanding test and went further than he was prepared to submit. Mr Thompson was right to take this approach. The decision of the Court of Appeal was reversed by the House of Lords on almost every ground: [1989] AC 755. The second passage from the judgment of Nourse LJ was specifically disapproved by Lord Oliver, with whom all the other members of the House agreed, at pp. 777-778.

162. In *Official Receiver v Stern* [2001] EWCA Civ 1787, [2002] 1 BCLC 119, Sir Andrew Morritt V-C, giving the judgment of this court (the other members being Buxton and Arden LJJ), said at [32] that the normal principle that the shareholders may waive or ratify a breach of duty by the directors did not apply "if the company is insolvent", citing in support *West Mercia* and the passage from Street CJ's judgment in *Kinsela* quoted by Dillon LJ.

163. Mr Thompson relied on a series of decisions, mainly at first instance, to establish, first, that the creditors' interests duty arises in circumstances short of actual insolvency and, second, that the trigger for the duty is that the company faces, or as a result of the proposed transaction would face, a real as opposed to a remote risk of insolvency. In most of these cases, the issue did not arise for decision because the company in question was in fact insolvent, as the directors knew or should have known. Equally, for that reason, there is no real discussion of the issue in most of these cases.

164. In my judgment, the Judge's observation at [465] was well made:

> "Statements of principle may be expressed more broadly than is warranted by the facts of the particular case. But where a formula extending the creditors' interests duty to a situation

> short of insolvency is cited by the court in a case where the company was in fact found to be insolvent or to be very close indeed to insolvency, or conversely where the court was satisfied that there was no problem with the company's solvency, it is unlikely that the court had turned its mind to the precise point at which a solvent company crosses some threshold which causes the creditors' interests duty to arise."

165. The English decisions at first instance begin with *Facia Footwear Ltd v Hinchcliffe* [1998] 1 BCLC 218. This was an application for summary judgment for relief in respect of payments totalling a little over £10.7 million alleged to have been made by the directors in breach of their fiduciary duties. The payees were for the most part hopelessly insolvent at the time of the payments, with no prospect of being able to repay them (see p. 225e-f). The paying company was also "in a very dangerous financial position" and its future, like the rest of the group, probably depended on satisfactory refinancing arrangements becoming available (see p. 228c). In other words, the company was probably insolvent, unless and until such refinancing arrangements were agreed.

166. Having referred to the judgments in *Walker v Wimborne*, *Permakraft*, *Kinsela* and *West Mercia*, Sir Richard Scott V-C said at p. 228b-c:

> "These authorities and the principles expressed in them entitle Mr Crystal to submit that the duty owed by Mr Hinchliffe and Mr Harrison to Facia Footwear Ltd in April and May 1996 was a duty that required them to take into account the interests of creditors. The whole Facia Group, and Facia Footwear Ltd as an individual company, were in a very dangerous financial position. The future of the group probably depended on satisfactory refinancing arrangements becoming available."

167. He added at p. 228f that he accepted that "given the parlous financial state of the group, the directors had to have regard to the interests of creditors" but refused summary judgment on the grounds that it was arguable that the creditors' interests were best served by a continuation of trading while negotiations for a refinancing continued.

168. In the present case, at [474], the Judge reviewed a number of other first instance decisions in England where judges have made statements as to the circumstances in which directors must have regard to the interests of creditors. In most of them, the company was clearly insolvent: *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch), [2003] BCC 885, *Re MDA Investment Management Ltd* [2003] EWHC 2227 (Ch), [2004] 1 BCLC 217, *Roberts (Liquidator of Onslow Ditchling Ltd) v Frohlich* [2011] EWHC 257 (Ch), [2011] 2 BCLC 625, *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [2012] 2 BCLC 369 and *Vivendi SA v Richards* [2013] EWHC 3006 (Ch), [2013] BCC 771.

169. The precise terms in which the duty is said to arise differ but a frequently used formulation is that it arises where the company "is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors' money which is at risk", in which case the interests of creditors are paramount: see the judgment of Leslie Kosmin QC,

a company lawyer of great experience, in the *Colin Gwyer* case. A different form of words, but not in my view showing any difference in substance, was used by Park J in *Re MDA Investment Management Ltd* at [70], citing *West Mercia* and *Facia Footwear Ltd v Hinchcliffe* in support:

> "Second, however, when a company, whether technically insolvent or not, is in financial difficulties to the extent that its creditors are at risk, the duties which the directors owe to the company are extended so as to encompass the interests of the company's creditors as a whole, as well as those of the shareholders."

170. In fact, Park J held that the company was insolvent. A winding-up petition had been presented against it and, whether or not it was "technically insolvent", it was as the director knew "in a dangerous financial position". Lewison J adopted Park J's formulation in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at [1304], again with the support of the same authorities.

171. In *Re Loquitur Ltd* [2003] EWHC 999 (Ch), [2003] 2 BCLC 442, Etherton J said, when dealing with an application for relief from liability, that the best interests of the company in that case included the interests of its creditors since the effect of the dividend in issue was, as the directors knew or ought to have known, "to render [the company] insolvent or potentially insolvent", for which the *dicta* of Cooke J in *Permakraft* and Templeman LJ in *Re Horsley & Weight* were cited. *Re Loquitur* was a case of a dividend rendered unlawful by a failure to make a necessary provision against a liability in the company's accounts. If the provision had been made, the company's accounts would have shown it to be insolvent.

172. These authorities at first instance provide some support for the proposition that something short of actual, or established, insolvency will be sufficient to trigger the creditors' interests duty but none of these English cases provides any support for the formulation for which BTI contends, that there is a real as opposed to a remote risk of insolvency

173. However, in *Vivendi SA v Richards*, Newey J cited a passage from another decision of the New South Wales Court of Appeal which referred to a test of a real, as opposed to a remote, risk to creditors. In *Vivendi*, the company was in fact insolvent. As the directors knew, the company had large rental and other liabilities but no income and, unless the liabilities were reduced or new sources of income were found within a relatively short period, the company would be unable to meet them.

174. Newey J first cited *West Mercia* and the passage from Street CJ's judgment in *Kinsela* approved by Dillon LJ. He observed that the "interests of creditors can "intrude" even when a company may not strictly be insolvent" and cited Mr Kosmin's judgment in the *Colin Gwyer* case. He then said:

> "150. Recent Australian authority is to similar effect. For example, in *Kalls Enterprises Pty Ltd v Baloglow* [2007] NSWCA 191; (2007) 25 A.C.L.C. 1094, Giles J.A. (with whom Ipp and Basten JJA agreed) said (at [162]):

> "It is sufficient for present purposes that, in accord with the reason for regard to the interests of creditors, the company need not be insolvent at the time and the directors must consider their interests if there is a real and not remote risk that they will be prejudiced by the dealing in question. "

This passage was quoted with apparent approval in *Bell Group Ltd v Westpac Banking Corp* [2008] WASC 239 and, on appeal, *Westpac Banking Corp v Bell Group* [2012] WASCA 157. At first instance, Owen J having quoted from *Kalls* (above), said (at [4445]):

> "The basic principle is that a decision that has adverse consequences for creditors might also be adverse to the interests of the company. Adversity might strike short of actual insolvency and might propel the company towards an insolvency administration. And that is where the interests of creditors come to the fore."

175. It is noteworthy that Newey J regarded the test of a real as opposed to a remote risk to creditors as being "to similar effect" as the test of "insolvent or of doubtful solvency or on the verge of insolvency". The same view was taken by John Randall QC, siting as a deputy High Court Judge, in *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch), [2014] BCC 337 who said that he did "not detect any difference in principle behind these varying verbal formulations". He continued:

> "It is clear that established, definite insolvency before the transaction or dealing in question is not a pre-requisite for a duty to consider the interests of creditors to arise. The underlying principle is that directors are not free to take action which puts at real (as opposed to remote) risk the creditors' prospects of being paid, without first having considered their interests rather than those of the company and its shareholders. If, on the other hand, a company is going to be able to pay its creditors in any event, *ex hypothesi* there need be no such constraint on the directors. Exactly when the risk to creditors' interests becomes real for these purposes will ultimately have to be judged on a case by case basis. Different verbal formulations may fit more comfortably with different factual circumstances."

176. In the present case, the Judge at [477] agreed with the view of Mr Randall QC that the authorities treated these various formulations as different expressions of the same test. If that is right, it is fatal to BTI's submission, because it has to postulate a lower test than "doubtful solvency" or "on the verge of insolvency" and for that reason advances a test of a real, as opposed to a remote, risk of insolvency. In my view, as a matter of language, the tests are different. A real, as opposed to a remote, risk of insolvency can arise even though the company is not insolvent and may very well never become insolvent. It sets a less demanding test than that adopted by Cooke J in *Permakraft*, that the company is *likely* to become insolvent.

177. The final English case to which I should refer is *Bilta (UK) Ltd v Nazir*. This was an application to strike out proceedings brought by the liquidator of the claimant company against the directors and others for damages for conspiracy and for relief for fraudulent trading, on the grounds that the action was barred by the claimant's participation in the alleged conspiracy and the maxim *ex turpi causa non oritur actio*. The duties of directors were relevant. At first instance, Sir Andrew Morritt C said that it was not disputed that "in circumstances where the company is or is likely to become insolvent the requirement to consider and act in the interests of creditors is imposed on the directors of the company": [2012] EWHC 2163 (Ch), [2014] Ch 52 at [28]. Referring to section 172(3) of the Companies Act 2006, Patten LJ said in this court that "the obligation to act in the interests of creditors arises in circumstances where the company is or is likely to become insolvent and is no more than a statutory recognition of the decision of this court in *West Mercia Safetywear Ltd v Dodd*": [2014] EWCA Civ 968, [2014] Ch 52 at [22]. Patten LJ went on to say that the company never had any substantial assets of its own and that the purpose of the conspiracy was to deprive it of the moneys payable to it, so that it was insolvent from the moment that it entered into the relevant transactions. The duty of the directors to consider the interests of creditors was therefore engaged from the start.

178. In the Supreme Court ([2015] UKSC 23, [2016] AC 1), the creditors' interests duty was commented on in two judgments. After referring to the duty to promote the success of a company in section 172(1), Lord Sumption said at [104]:

> "The common law goes further than this, treating the interests of an actually or prospectively insolvent company as synonymous with those of its creditors: *West Mercia Safetyware v Dodd* [1988] BCLC 250. The duty to have regard to the interests of creditors is not one of the general duties of directors identified in the statute, but the common law duty is preserved by section 172(3) of the Act, notwithstanding the directors' obligation to serve the interests of members."

179. In their joint judgment, Lord Toulson and Lord Hodge said at [123]:

> "123. It is well established that the fiduciary duties of a director of a company which is insolvent or bordering on insolvency differ from the duties of a company which is able to meet its liabilities, because in the case of the former the director's duty towards the company requires him to have proper regard for the interest of its creditors and prospective creditors. The principle and the reasons for it were set out with great clarity by Street CJ in *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722,730."

180. They then set out the familiar passage from Street CJ's judgment and the fact of its approval by Dillon LJ in *West Mercia*. At [126] they said that the protection given by the law to the creditors of an insolvent company is through the creditors' interests duty owed by directors.

181. Mr Thompson sought support from the Australian cases in which the phrase "a real, as opposed to a remote, risk of insolvency" has been used.

182. The first is a decision of the Supreme Court of South Australia, *Grove v Flavel* (1986) 11 ACLR 161. This was the determination of a point of law on an appeal against the conviction of the appellant of an offence under the Companies Act 1962 of South Australia that as an officer (in this case, a director) of a company he made improper use of information acquired by virtue of his position as such officer. The information was that the company was in serious financial difficulty and that its liquidation was a definite possibility. Using that information, the appellant arranged for debts to companies in which he was interested to be repaid or for those debts to be taken over by solvent companies.

183. The Court (Jacobs, Matheson and Olsson JJ) held that, because "officer" included a wide range of persons, whether the use was improper had to be judged by reference to the particular duties and responsibilities of the particular officer, in this case a director. Jacobs J, with whom the other judges agreed, cited at length passages from the judgments in *Walker v Wimborne, Permakraft* and *Kinsela*. He said at p. 169:

> "It was by reason of the uncertainty, upon the cases, of the ambit of a director's duty to creditors in cases in which a company is not shown to be insolvent, but is in obvious financial difficulties, that the respondent sought to establish a general duty to creditors irrespective of insolvency or financial difficulties, but it seems to me that as a matter of law there is middle ground which the respondent can occupy in the circumstances of this case…
>
> I would state the basis upon which such actions are to be judged "improper" as follows:
>
> 1. A director of a company X Ltd who, upon acquiring information which leads him to believe that the company faces a risk of liquidation, whether voluntary and because it cannot pay its debts as they fall due or at the suit of creditors, which is a real and not a remote risk, thereupon acts to protect himself and other companies of which he is a director from the consequences of such liquidation, to the possible detriment of the creditors of X Ltd, is acting "improperly" as a director of X Ltd because:
>
> (a) There can be no doubt of such possible detriment when the action taken involves a disposition of the assets of X Ltd, in this case debts owing to X Ltd, which would be part of the fund available to creditors generally in the event of liquidation. It is in the words of Richardson J in *Nicholson & Ors v Permakraft (NZ) Ltd (in liq), supra,* "the creditors' money that is at stake".
>
> (b) If that is the principle which dictates the "duty" of a director to have regard to the interest of creditors when the company is known to be insolvent there can be no reason in principle why knowledge of a real risk of insolvency should not attract the same duty.

> 1. Whether there is such a real and perceived risk of insolvency must depend upon the facts of the particular case."

184. This is of very limited assistance to BTI's case. The issue was whether the appellant had acted improperly in the use of information "to gain directly or indirectly an advantage for himself or for any other person or to cause detriment to the corporation". That was the question to which Jacobs J directed himself in the quoted passage, stating that a director acts improperly when he uses information acquired by him as a director that the company faces a risk of liquidation "to protect himself and other companies of which he is a director from the consequences of such liquidation". Like section 423 of the Insolvency Act, the offence is dependent on the subjective motive of the officer, in this case to obtain a personal advantage or cause loss to the company.

185. *Kalls Enterprises Pty Ltd v Baloglow* [2007] NSWCA 191, (2007) 25 ACLC 1,094 (*Kalls*), to which Newey J referred in *Vivendi SA v Richards*, was a decision of the New South Wales Court of Appeal (Giles JA, Ipp JA and Basten JA). Two companies (KE and AA) at different times carried on a laundry business. KE sold the business to a third party and, out of the proceeds of sale, Mr Kalls, a director of both companies, caused a sum of $555,000 to be paid to Mr Baloglow in settlement of a debt due from Mr Kalls personally. The common liquidator of KE and AA made a claim for repayment of that sum against Mr Baloglow on the grounds that, *inter alia*, he received it with knowledge that Mr Kalls paid it to him in breach of Mr Kalls' duties as a director of both companies.

186. Both companies were insolvent at the time of the payment or, in the case of AA, became so as a result of the payment: see [166], [171]-[173] and [234]. The court addressed the knowledge that Mr Kalls and Mr Baloglow had of the companies' financial position, necessary to establish liability respectively for breach of duty and knowing receipt of the payment. At [174], Giles JA (with whom the other judges agreed on this part of the case) said that the sale of the business disposed of the only income-earning asset of the companies and the payment of the $555,000 prejudiced creditors because it was not available for the payment of creditors of the laundry business. He said: "There was at the least a real and not remote risk that the diversion of the proceeds of sale used to pay Mr Baloglow would prejudice creditors of AA and of [the business]…Mr Kalls must have been aware of that risk if he gave any thought to the interests of creditors". As for Mr Baloglow, he knew that, having himself received the $555,000, KE could not pay that sum to its beneficial owner, AA, and that AA's money was being used by Mr Kalls to pay a personal liability, not a liability of KE or AA. Quite apart from the interests of creditors, Mr Baloglow was put on notice of Mr Kalls' breach of duty. In addition, although not necessary to establish liability to account, Mr Baloglow knew of a number of matters going to the likely detriment to creditors: see [180]-[199]. At [197], Giles JA said:

> "Mr Baloglow may not have had clear knowledge of insolvency of TQLS, which to him equated to AA. Knowledge of insolvency was not necessary for knowledge of breach of fiduciary duty. It was sufficient, if with his knowledge, Mr Baloglow wilfully and recklessly failed to make the enquiries an honest and reasonable man would make about a real and not

> remote risk that creditors would be prejudiced by payment to him of the $555,000, or that an honest and reasonable man would have thought that there was that risk."

187. Giles JA laid the ground for this approach at [162]:

> "At least where the company is facing insolvency as well as considering the company's interests the directors must consider the interests of its creditors: *Walker v Winborne* (1976) 137 CLR 1; *Kinsela v Russell Kinsela Pty Ltd (in liquidation)* (1986) 4 NSWLR 722. In *Grove v Flavel* (1986) 43 SASR 410 the Court said at 421 that the interests of creditors must be considered where to the knowledge of the directors there is a real and not remote risk of insolvency, and of course the risk includes the effect of the dealing in question. (*Grove v Flavel* was disapproved in *Spies v The Queen* (2000) 201 CLR 603 at [95] so far as it suggested a direct duty owed to and enforceably by creditors, but not as to this matter.) It is sufficient for present purposes that, in accord with the reason for regard to the interests of creditors, the company need not be insolvent at the time and the directors must consider their interests if there is a real and not remote risk that they will be prejudiced by the dealing in question."

188. These statements in *Kalls* provide a greater measure of support for BTI's case that the test is one of a real, as opposed to a remote, risk of insolvency but it was a case where the companies in question were in fact insolvent at the relevant time and where the individuals concerned had knowledge of the companies' precarious financial position.

189. The last of the Australian cases is *The Bell Group Ltd v Westpac Banking Corporation* [2008] WASC 239, 70 ACSR 1 (Owen J) and [2012] WASCA 157, 89 ACSR 1 (Western Australia Court of Appeal) (*Westpac*). This massive litigation arose out of the high-profile collapse of the Bell Group. Issues arose as to the duties of directors to have regard to the interests of creditors. Owen J discussed these issues in some detail. In a passage at [4441]-[4450], he considered whether the obligation may arise other than in actual insolvency. As he noted at [4441], it was not necessary for him to answer this point, because he had found that the major companies in the group were insolvent at the relevant time, but, as he put it, he proffered his views. The defendant banks contended that the creditors' interests duty arose only if the company were insolvent and not when it was nearly insolvent or of doubtful solvency or even where it would inevitably become insolvent. He referred to a number of Australian authorities in which, as in the English cases, the duty has been said to arise where the company is "insolvent or verging on insolvency" or nearing, approaching or being confronted by insolvency. Having cited *Kalls*, Owen J said at [4445]:

> "In my view these statements all suggest that a financial state short of actual solvency [*this must be a misprint for* "*insolvency*"] could be sufficient to trigger the obligation to take into account the interests of creditors. Again, in my view, this approach accords with principle. The basic principle is that a decision that has adverse consequences for creditors might

> also be adverse to the interests of the company. Adversity might strike short of actual insolvency and might propel the company towards an insolvency administration. And that is where the interests of creditors come to the fore."

190. The issue was discussed on appeal in the judgment of Drummond AJA at [2031]-[2051]. He described it at [2031] as the principle that directors must have regard and give effect to the interests of creditors "if the company is sufficiently financially distressed". At [2036], he cited, as the reason for the imposition of the duty, the passage in Street CJ's judgment in *Kinsela* which was cited with approval by Dillon LJ in *West Mercia*, namely that the creditors have in such circumstances in a practical sense an interest in the assets of the company. At [2039], he noted that the doctrine is still in the process of development and "Just what state of corporate financial distress will be sufficient to trigger the duty and whether the duty is owed not only to present creditors but to future ones have not yet been settled in all jurisdictions which recognise the principle". At [2043] he refers to the application of the duty in cases where the company was "insolvent or near insolvent" and at [2046] he said that "if the circumstances of the particular case are such that there is a real risk that the creditors of a company in an insolvency context would suffer significant prejudice if the directors undertook a certain course of action, that is sufficient to show that the contemplated course of action is not in the interests of the company".

191. In my view, these *obiter* comments in *Westpac* do not support, but are inconsistent with, an extension of the relevant test from insolvency or near insolvency to a real, as opposed to a remote, risk of insolvency, at any rate if that latter formula is to mean anything different from insolvency or near insolvency.

Breach of duty: conclusion on the authorities

192. I have discussed these authorities at length for two reasons. First, it was Mr Thompson's submission that the authorities established that the trigger for the common law duty to have regard to the interests of creditors was when the company faced a real, as opposed to a remote, risk of insolvency. Second, as section 172(3) applies the common law duty, it is necessary to identify the trigger as it appears from the authorities.

193. As will be apparent from comments made in the course of reviewing the authorities, I am satisfied that they do not establish the trigger for which Mr Thompson contends. In a few instances, notably in *Kalls*, the trigger is expressed in those terms, but consistently in the great majority of cases up to and including *Bilta v Nazir* it is expressed in much less expansive terms. It may be that in those few cases, as the Judge in the present case thought, it was just a different way of saying the same thing but that is of no use to Mr Thompson.

194. As to what trigger is established, many of the cases go beyond actual insolvency to include something close to insolvency.

195. There is no decision in any English authority which is clearly based on the proposition that the creditors' interests duty is triggered by anything short of actual insolvency. In all the cases, the company was insolvent, as the directors knew or ought to have known, and in few (if any) cases does this seem to have been the subject of argument.

Nonetheless, the number of times that judges, many of them with considerable experience in this field, have assumed that something less than actual insolvency will trigger the duty carries weight.

Breach of duty: other considerations

196. Approaching the issue as one of principle, rather than authority, Mr Thompson submitted that the test of a quasi-proprietary interest, as approved by this court in *West Mercia*, was insufficient because it can apply only in cases of actual insolvency, and the authorities establish that something short of actual insolvency will trigger the duty. Mr Thompson submitted the test should be triggered at the time when it can be said that the creditors have a sufficiently strong stake in the conduct of the company's business and activities. He identified this time as when there is a real risk that a decision of the directors to pursue, or not to pursue, a particular course may lead to the company's insolvency. If, for example, a company is only just solvent, it is the creditors who will lose if the risk eventuates. In other cases – where, for example, there is a greater balance of net assets or where the risk is of a claim with, say, a 40% chance of success – the interests of both shareholders and creditors are more clearly engaged.

197. Many of the authorities speak of the interests of creditors being paramount when the duty to take account of their interests arises. Mr Thompson submitted that this is the case only if the company is actually insolvent or very close to it. In other cases, the directors must take account of the interests of both shareholders (and the other interests listed in section 172(1)) and creditors. Provided they do so, and it is a decision which they could reasonably make, a decision to proceed in a way which puts the interests of creditors at risk will not involve a breach of duty. In the case of the May dividend, the test of a real risk was triggered by a dividend which left AWA with the Maris policy, a low level of net assets on the balance sheet and the historic insurance policies as its only assets, when there was a material risk that the indemnity liability would exceed the value of those assets. Payment of the dividend was incapable of providing any benefit to the company or its creditors, unlike for example investment in a new business.

198. It is to be noted that the interests of creditors are not listed in section 172(1) as one of the matters to which directors must have regard when deciding, as required by section 172(1), what is most likely to promote the success of the company for the benefit of the members as a whole. The duty to promote the success of the company is subject, by the terms of section 172(3), in certain circumstances to the obligation to consider or act in the interests of creditors. It is true that section 172(3) includes considering the interests of creditors, as well as acting in their interests, and that it is only the latter phrase which suggests that their interests will be paramount. Nonetheless, the interests of creditors are identified as interests different from, and potentially in conflict with, the promotion of the success of the company for the benefit of its members as a whole.

199. The reconciliation of the duty under section 172(1) and the creditors' interests duty will, unless creditors' interests are paramount, present difficulties. Take the case of a company which is solvent and has cash resources available to meet a liability due to mature in two years' time. The interests of creditors would be served by retaining the cash until the liability matures, investing it in the meantime in risk-free assets. The

company has an opportunity to invest the funds in a business venture that carries significant risks and rewards. It would not be a foolhardy investment but, if the real risk of failure occurs, it is the creditors who will lose. If BTI's submissions were accepted, I do not believe that in such circumstances directors could be advised that they would not run any real risk of being held to have acted in breach of duty. Of course, there could be argument about it, but in the real world directors do not usually court these personal risks.

200. These difficulties do not mean that it would necessarily be wrong to adopt the test proposed by BTI, but it would be a new test, not anchored to the quasi-proprietary interests of creditors in the assets of an insolvent company. It is a test that predictably would have a chilling effect on entrepreneurial activity, when such activity is the underlying purpose of most registered companies.

201. The adoption of any legal test for triggering the creditors' interests duty involves, as Richardson J said in *Permakraft*, "a difficult amalgam of principle, policy, precedent and pragmatism". It is a decision that will have very significant practical consequences for the conduct of business and it is therefore a decision best taken on an informed basis as to those consequences. In the light of that information, a policy decision can be taken.

202. The present structure of section 172, and the wording of section 172(3), implicitly recognise that a precise statement of the trigger is difficult. This is apparent from the process which led to the enactment of the Companies Act 2006. In 1998, the Government established the Company Law Review Steering Group (CLRSG) to undertake a thorough review of company law and legislation. The CLRSG recommended a codification of directors' duties but initially and provisionally rejected the idea of including any statement of a duty as regards creditors.

203. In its final report, published in 2001, the CLRSG by a majority took a different view: see *Modern Company Law for a Competitive Economy* at paras 3.12-3.20. The report stated that "In providing a high level statement of directors' duties, it is important to draw to directors' attention that different factors may need to be taken into consideration where the company is insolvent or threatened with insolvency". The majority recommended a statement that contained two elements. First, it should reiterate the test for the personal liability of directors under section 214 of the Insolvency Act 1986 (a failure to take all reasonable steps to reduce the loss to creditors "where they ought to have recognised that the company had no reasonable prospect of avoiding insolvent liquidation"). Second, it would require directors to take such steps as they thought appropriate to reduce the risk to creditors where they knew or ought to recognise that there was "a substantial probability of an insolvent liquidation". This was envisaged as requiring a balanced judgment, meeting the legitimate interests of shareholders and creditors alike. The concerns that this duty could have a chilling effect on business activity would be met, it was suggested, by providing that the duty would arise only "when the directors ought in the exercise of due care and skill to recognise that a failure to meet the company's liability is more probable than not". As the report said: "Directors could thus safely be advised that it is only the greater than even probability of such failure which they need take account of – which might be some comfort when faced with normal day-to-day business risk."

204. The minority position was stated as follows:

> "Others of us, believe, however, that even as drafted the principle gives inadequate guidance to directors and depends on their being able to discern an intermediate stage on the path to insolvency which is not identifiable in reality. In the view of these members the break from a going concern to an insolvent basis of trading is normally so abrupt and rapid in practice that references to calculating the probabilities and to "sliding scales" of risk and benefit are unhelpful and potentially misleading. The incorporation of the section 214 rule in the statement will, in their view, be sufficient in practice and would avoid the serious disadvantages of the broader and less precise principle. The advantages and disadvantages of such a principle are very much a matter of commercial judgment, on which we have not been able to reach an agreed view nor, in the time available, to consult on the basis of a clear draft. We recommend that the DTI should do so."

205. The Government's response (*Modernising Company Law* Cm 5553-1, July 2002) did not accept the majority recommendation but concluded that the weight of the argument was against the inclusion of any statement of duties as regards creditors. The Government's position was that:

> "Directors would need to take a finely balanced judgment, and fears of personal liability might lead to excessive caution. This would run counter to the 'rescue culture' which the Government is seeking to promote through the Insolvency Act 2000 and the Enterprise Bill now before Parliament."

206. When, in 2005, the Government published a further White Paper, *Company Law Reform* (Cm 6456), it included in a draft bill a provision in the terms now enacted as section 172(3). There was no discussion in the White Paper of the reasons for the change in position since 2002, but the notes to the bill stated that the provision recognised "that the normal rule that a company is to be run for the benefit of its members as a whole may need to be modified where the company is insolvent or threatened by insolvency. In doing so, it preserves the current legal position that, when the company is insolvent or is nearing insolvency, the interests of the members should be supplemented, or even replaced, by those of the creditors."

207. The explanatory notes to section 172(3) state:

> "331. *Subsection (3)* recognises that the duty to promote the success of the company is displaced when the company is insolvent. Section 214 of the Insolvency Act 1986 provides a mechanism under which the liquidator can require the directors to contribute towards the funds available to creditors in an insolvent winding up, where they ought to have recognised that the company had no reasonable prospect of avoiding insolvent liquidation and then failed to take all reasonable steps to minimise the loss to creditors.

> 332. It has been suggested that the duty to promote the success of the company may also be modified by an obligation to have regard to the interests of creditors as the company nears insolvency. *Subsection (3)* will leave the law to develop in this area."

208. The reference to the suggestion of a duty to have regard to the interests of creditors "as the company nears insolvency" is to cases such as *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd.*

209. There is nothing, in my view, in the Reports and White Papers preceding the enactment of the Companies Act 2006 that would suggest an intention to adopt or encourage the development of a wide test of the sort proposed by BTI in this case. The suggestion is more that the precise content of "near insolvency" may require development. The discussion in the Reports and White Papers emphasises the difficult policy issues to which the choice of test gives rise.

210. In certain circumstances, where the interests of shareholders may most obviously conflict with the interests of creditors, the Companies Act 2006 contains special provisions to provide protection to the interests of creditors. The payment of dividends is, of course, one such area, with the detailed code contained in Part 23. Another area is a reduction of share capital undertaken without court approval. Section 642 requires the directors to make a "solvency statement" not more than 15 days before the special resolution authorising the reduction is passed. Section 643 defines a solvency statement:

> "(1) A solvency statement is a statement that each of the directors-
>
> (a) has formed the opinion, as regards the company's situation at the date of the statement, that there is no ground on which the company could then be found to be unable to pay (or otherwise discharge) its debts; and
>
> (b) has also formed the opinion-
>
> (i) if it is intended to commence the winding up of the company within twelve months of that date, that the company will be able to pay (or otherwise discharge) its debts in full within twelve months of the commencement of the winding up: or
>
> (ii) in any other case, that the company will be able to pay (or otherwise discharge) its debts as they fall due during the year immediately following that date.
>
> (2) In forming those opinions, the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities)."

211. A similar but not identical statement is required to be made by the directors of a private company proposing to purchase or redeem its own shares out of capital. Section 714 provides as regards such a statement:

> "(3) It must state that, having made full inquiry into the affairs and prospects of the company, the directors have formed the opinion-
>
> (a) as regards its initial situation immediately following the date on which the payment out of capital is proposed to be made, that there will be no grounds on which the company could then be found unable to pay its debts, and
>
> (b) as regards its prospects for the year immediately following that date, that having regard to-
>
> (i) their intentions with respect to the management of the company's business during that year, and
>
> (ii) the amount and character of the financial resources that will in their view be available to the company during that year,
>
> the company will be able to continue to carry on business as a going concern (and will accordingly be able to pay its debts as they fall due) throughout that year.
>
> (4) In forming their opinion for the purposes of subsection (3)(a), the directors must take into account all of the company's liabilities (including any contingent or prospective liabilities)."

212. It is not necessary to determine whether the requirements of these statements go further than required by the test proposed by BTI or not as far. Either way, it demonstrates that when Parliament considers it appropriate to provide protection for creditors going beyond that required in the case of a company that is insolvent or "near to insolvency", it does so.

213. The authorities and the submissions in this case suggest that there are at least four possible answers to the question of when the creditors' interests duty is triggered. First, it may be when the company is actually insolvent, either on a cash-flow or balance sheet basis. The decision in *West Mercia* authoritatively establishes that at least at this point the duty is engaged. Second, it may arise when the company is on the verge of insolvency or nearing or approaching insolvency. Phrases such as these have been used in a number of the cases. Third, it may arise when the company is or is likely to become insolvent. This is, I think, what judges mean when they refer to a company as being of dubious solvency. Fourth, it might be the trigger advanced by BTI, where there is a real, as opposed to a remote, risk of insolvency. Other phrases, such as the company being in a parlous financial state or in financial difficulties, could fall within either the second or third categories, assuming that they convey something less than outright insolvency. Although they may be apt descriptions of a company's situation in particular cases, they are in my view too vague to serve as a useful test for the important step of engaging the creditors' interests duty.

214. As I have already indicated, I do not think that the second, third and fourth alternatives are just different ways of saying the same thing. As it seems to me, a real as opposed to a remote risk of insolvency is a significantly lower threshold than being either on the verge of insolvency or likely to become insolvent.

215. In my judgment, the test of a real, as opposed to a remote, risk of insolvency is not part of the present law as regards the creditors' interests duty, and it would not be appropriate, in the light of the policy considerations and other provisions of the Companies Act to which I have referred, for the courts to introduce such a test as a development of the common law.

216. I have, however, concluded that the duty may be triggered when a company's circumstances fall short of actual, established insolvency. This is certainly the view taken by many judges in the cases to which I have referred. However, for good reason, not least because it has rarely been necessary, judges have shied away from a single form of words, preferring instead a variety of expressions such as those that I have mentioned.

217. More than one explanation of the underlying rationale has been advanced in the cases but the prospective interest of creditors in the assets of an insolvent company put forward by Street CJ in *Kinsela* and expressly adopted by this court in *West Mercia* is not simply the only rationale authoritatively established in this jurisdiction but continues to attract support; see, for example, *Westpac* and *Bilta (UK) Ltd v Nazir*.

218. An inconsistency might be said to exist between that rationale and the many statements that extend the trigger to a state of near-insolvency. I do not, however, think that there is an inconsistency. The precise moment at which a company becomes insolvent is often difficult to pinpoint. Insolvency may occur suddenly but equally the descent into insolvency may be more gradual. The qualified way in which judges have expressed the trigger (and I am among them; see *Burnden Holdings (UK) Ltd v Fielding* [2016] EWCA Civ 557, [2017] 1 WLR 39 at [18]) reflects that the directors may often not know, nor be expected to know, that the company is actually insolvent until some time after it has occurred. For this reason, among others, a test falling short of established insolvency is justified.

219. I consider there to be a problem with formulations in the second category, such as being on the verge of insolvency, because they suggest a temporal test. If the test is that insolvency is "imminent", or if similar words are used, it suggests that actual insolvency will be established within a very short time. That may well describe many situations in which the duty is triggered, but it does not or may not cover the situation where, although the company may be able to pay its debts as they fall due for some time, perhaps a considerable time, to come, insolvency is nonetheless likely to occur and decisions taken now may prejudice creditors when the likely insolvency occurs.

220. Judicial statements should never be treated and construed as if they were statutes but, in my judgment, the formulation used by Sir Andrew Morritt C and Patten LJ in *Bilta v Nazir*, and by judges in other cases, that the duty arises when the directors know or should know that the company is or is likely to become insolvent accurately encapsulates the trigger. In this context, "likely" means probable, not some lower test such as that adopted by Hoffmann J in construing the statutory test for the making of an administration order: see *Re Harris Simons Construction Ltd* [1989] 1 WLR 368.

221. I am therefore satisfied that the judge was correct to reject BTI's case that the applicable trigger for the creditors' interests duty was a real, as opposed to a remote, risk of insolvency.

222. As I have earlier mentioned, an important issue is whether, once the creditors' interests duty is engaged, their interests are paramount or are to be considered without being decisive. This is not straightforward, and there has been a good deal of discussion about it in some of the cases and in the academic literature. It is not an issue that arises on the facts of this case and, in my view, it should be addressed on the facts of cases where it must be decided. I therefore express no view on it, save to say that where the directors know or ought to know that the company is presently and actually insolvent, it is hard to see that creditors' interests could be anything but paramount.

223. There are some related submissions that I should mention.

224. First, Mr Rabinowitz submitted that, whatever the content of or trigger for the creditors' interests duty, it did not apply to the payment of dividends, because Part 23 and the common law rules on the maintenance of capital occupied the whole field and left no room for any further duty or restriction. I have earlier acknowledged that the existence of the detailed provisions of Part 23 and the protection they are intended to provide are highly relevant factors in determining the extent and scope of any creditors' interests duty. But, despite the skill with which Mr Rabinowitz developed this argument, it is in my view unsustainable. The problem facing his submission is that, even in the case of an insolvent company, Part 23 does not occupy the whole field. An example will show this. The latest accounts of a company show distributable profits and the directors propose to pay a dividend that does not exceed those profits. There has been no diminution in the value of the company's assets since the date of the accounts nor have the total liabilities increased since that date. The payment of a dividend would not therefore represent a return of capital. However, the dividend would exhaust the company's cash resources and, let it be assumed, the company would be unable to raise cash from other sources after the dividend was paid. Payment of the dividend would therefore leave the company unable to pay its debts as and when they fell due. The company would be insolvent on a cash-flow basis, but not on a balance sheet basis. Part 23 would not prohibit the payment of the dividend, but the creditors' interests duty established by the authorities would do so. It would be a breach of duty by the directors to pay the dividend, and it would not be open to ratification by the shareholders.

225. Second, Mr Thompson submitted that the Judge had based her decision on timing alone. It was, he submitted, only because the extent of the indemnity liability of AWA would not be resolved for a considerable period after May 2009 that the Judge held that the creditors' interests duty did not apply. Having read and re-read the judgment at [477]-[484], I can see no basis for characterising the judge's reasoning in this way. I will not seek to summarise the Judge's reasoning, as it is in my view clearly set out in those paragraphs. It has nothing to do with timing but is centred on the degree of risk.

226. Both Lord Goldsmith and Mr Thompson were keen for us to consider what the position would be if the dividend were proposed a short period of days or weeks before a decision of a final court of appeal which would determine the existence and

extent of the indemnity liability. Assume, they suggested, that the bona fide and reasonable estimate by the directors of an adverse result were no more than 40%. I consider this to be an artificial exercise. If a decision were that close, there would be a mass of further information available to the directors, including assessments of the company's position as it had developed in the course of the proceedings. There are far too many variables to make it sensible to address this example outside a case in which it arises.

227. Third, Mr Thompson advanced an alternative case that, if the trigger were one of doubtful solvency, it was satisfied on the findings of fact made by the Judge. He submitted that in May 2009, AWA was "in jeopardy of insolvency" and close to insolvency, although not in a temporal sense. There were great uncertainties about the extent of its indemnity liabilities, as the auditors' emphasis of matter demonstrated. A trial of a preliminary issue that could have a significantly adverse effect on AWA's position, subject to appeals, was fixed in the United States for December 2009. As the Judge found in the section 423 claim, the May dividend was at least in part motivated by a desire to insulate Sequana against these possible liabilities.

228. None of this, however, can in my judgment amount to a finding that at the time of or as a result of the May dividend, AWA was insolvent or was likely to become insolvent. Given that the estimate of the liability made for the purposes of the accounts and for determining AWA's distributable profits is not challenged, it necessarily follows that BTI accepts that the liability, with or without the dividend, was unlikely to render AWA insolvent. In truth, this alternative submission is simply a repetition of BTI's main case that insolvency was a real, not a remote, risk.

229. I conclude, therefore, that the Judge was right to dismiss BTI's claim based on a breach of section 172(3).

230. In the alternative, BTI pleaded a case of breach of duty under other sections setting out the general duties of directors: section 171 (the duty to exercise powers for their proper purpose), section 173 (the duty to exercise independent judgment) and section 174 (the duty to exercise reasonable care, skill and diligence). Mr Thompson made clear that BTI was not pursuing the case under section 173.

231. As regards section 171, Mr Thompson submitted that BTI could rely on the finding made by the Judge in the section 423 claim that a purpose of the May dividend was to put the debt due from Sequana to AWA beyond the reach of AWA's creditors. This was not a proper purpose for the exercise of the power to pay dividends and therefore the directors acted in breach of section 171 in paying the dividend.

232. Although pleaded, this case was not advanced before the Judge. Indeed, in a document put before the Judge by BTI setting out the matters to be decided, no mention was made of this alleged breach. As Mr Rabinowitz put it, BTI seeks before us to deploy a finding made on a different claim by a different claimant against a different defendant (the directors not being parties to the section 423 claim) in order to advance this case for the first time. In my view, BTI is not now permitted to take this course. If it wished to pursue its pleaded case of improper purpose, it should have done so before the Judge. The course adopted by BTI meant that it abandoned this claim and there is no good reason for permitting it to be revived now, to be decided for the first time on appeal.

233. The finding required for the section 423 claim was that putting assets beyond the reach of creditors was one of the purposes (and not necessarily a causative purpose), and not just a consequence, of paying the dividend: see the judgment at [489]-[493]. To ground a claim under section 171, it was necessary for BTI to establish either that an improper purpose was the sole or dominant or primary purpose (*Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821), or, arguably, that the purpose was causative in the sense that, without it, the power would not have been exercised (*Eclairs Group Ltd v JKX Oil and Gas plc* [2015] UKSC 71, [2015] Bus LR 1395, per Lord Sumption and Lord Hodge). This raises issues of fact and law that did not need to be considered by the Judge and, rightly, she did not do so.

234. Further, on this alternative case, the creditors' interests duty is not engaged. In those circumstances, any breach of the duty to exercise the power for a proper purpose can be ratified by the shareholders, so as to preclude any claim by or on behalf of the company, while leaving in place any claim under section 423. This simply applies the decision in *West Mercia*. This was accepted by BTI but it was said that ratification had not been pleaded as a defence. Given that it was common ground that Sequana was AWA's holding company and that counsel made clear that, if the section 171 claim were pursued, ratification would be relied on as a defence, this is a point of no merit.

235. An alternative claim under section 174 was also bound to fail, because even if there had been a breach, which I find impossible to discern given the directors' unchallenged compliance with Part 23 and the accounting requirements as to provisions against liabilities, the May dividend was paid with the knowledge and consent of Sequana as the only shareholder.

236. It follows therefore that I would dismiss BTI's appeal as regards all claims for breach of duty by the directors of AWA in paying the May dividend.

Conclusion

237. The overall result, in my judgment, is that all the appeals and cross-appeals should be dismissed, save for Sequana's cross-appeal on the interest rate issue in the section 423 claim.

Lord Justice Henderson:

238. I agree.

Lord Justice Longmore:

239. I also agree.