



Restructuring and insolvency
Case Law Update
Rosling King LLP



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The Claim

Arjo Wiggins Appleton Limited (“AWA Limited”) was a wholly owned subsidiary of Sequana SA (the “Defendant”). BAT Industries Plc (“BAT Plc”), through a series of corporate acquisitions, became liable to pay for part of an environmental clean-up operation in the USA. AWA Limited was also liable to indemnify BAT Plc for part of that liability.

In December 2008, AWA Limited’s directors signed a solvency statement confirming that, in the opinion of the directors;

- (1) there were no grounds as at 15 December 2008 on which AWA Limited would be unable to pay or discharge its debts; and
- (2) AWA Limited would be able to pay or discharge its debts as and when they fall due in the following year.

The directors of AWA Limited thereafter resolved to pay the Defendant an interim dividend in the sum of €443 million. On 18 May 2009, AWA Limited’s directors resolved to pay a further interim dividend to the Defendant to release €135 million of the Defendant’s intra-group debt which was owed to AWA Limited. Later that day the Defendant sold AWA Limited.

Claims against the directors of AWA Limited and the Defendant were brought on the basis that:

1. the dividends paid to the Defendant were made contrary to Part 23 of the Companies Act 2006, because the accounts on which the directors relied when making the decision to pay out the dividends were not prepared correctly and therefore a reasonable decision could not have been made by the directors;
2. the decision to pay out the dividends was made in breach of the fiduciary duties the directors owed to AWA Limited; and
3. payment of the dividends was made contrary to section 423 of the Insolvency Act 1986.

The Judgment

The Court dismissed the claims brought under Part 23 of the Companies Act 2006 and in respect of the directors’ fiduciary duties towards AWA Limited but allowed BAT Plc’s claim under section 423 of the Insolvency Act 1986:

1. The Court held that when considering AWA Limited’s directors’ solvency statement under section 643 of the Companies Act 2006, the test of whether the company was able to pay or discharge its debts is not a technical one. It is a straightforward test in which you apply the words of the section and is not whether, if a calamity struck, the company would be able to pay its debts or whether the Court would have jurisdiction to wind the company up on a petition issued the same day the solvency statement was signed. The Court held that the test should be whether, on the date the solvency statement was signed, there were any grounds on which the company could be found to be unable to pay or discharge its debts, taking into consideration contingent

or prospective liabilities.

2. The Court also considered when the creditors' interest duty arose. The Court held that the essence of the test was whether the directors ought to be anticipating the company's insolvency in their conduct of the company's business. This is on the basis that when the directors start to anticipate the insolvency of the company the creditors, rather than the shareholders, then have a greater claim to the assets of the company. The Court stated that if the duty was owed to the creditors when the directors made a provision for a liability in the accounts which may be inadequate, this would seriously lower the threshold of the test and there was no justification for this change. The test should therefore be set at the level of being 'on the verge of insolvency' or of 'doubtful' or 'marginal' solvency, rather than at 'a real (as opposed to remote) risk of insolvency.' The Court held in this case that there was a real possibility that AWA Limited would never become insolvent and as such, the creditors' interest had not arisen when AWA Limited's directors made the decision to make the first and second dividend payments.

3. Finally, the Court held that section 423 of the Insolvency Act 1986 was drafted widely enough to include a dividend payment, on the basis that there is no wording in section 423 to exclude the payment of a dividend from the scope of the section, provided the payment was made with the intention of placing assets out of reach of a potential creditor or with the intention of prejudicing the interests of a person with a potential claim. Although the Court held that the dividend paid in December 2008 did not satisfy the test, as there was no settled intention of selling AWA Limited there could therefore be no intention to put AWA Limited's assets beyond the reach of BAT Plc at this time, the Court held that the dividend paid in May 2009 did satisfy the test under section 432, as there was evidence that the intention behind the dividend payment was to remove the risk from the Defendant's group that the liability owed by AWA Limited to BAT Plc would exceed the amount available to meet such a liability. It was on this basis that BAT Plc's claim under section 423 of the Insolvency Act 1986 was allowed.

Commentary

This case provides useful guidance on the requirement for directors to consider the contingent and prospective liabilities of the company when making a solvency statement. In addition, this case provides further clarity as to when the directors' duty to consider the interests of creditors over the interests of the shareholders arises, confirming that there is a single threshold applicable to all decisions which needs to be met. Finally, this decision is the first decision to hold that a dividend payment could be considered to be a transaction entered into at an undervalue for the purposes of section 423 of the Insolvency Act 1986 and serves as useful guidance as to the issues the courts will consider when faced with a section 423 claim.

For further information, please contact [James Walton](#) or the Partner with whom you usually deal.