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Feature

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# Was *ATP Oil* Correctly Decided?

## *Fifth Circuit Affirms Dismissal of Challenges to Dividends Declared on Eve of Bankruptcy*

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Consider this situation: A corporation is actively considering bankruptcy, yet it nevertheless asks counsel whether it can dividend $7 million to Series B stockholders. Counsel advises against the dividend, but the board of directors approves it anyway, and the company pays it only six weeks before filing a bankruptcy case.

This sounds like a bad idea, right? Surprisingly, perhaps not. The Fifth Circuit Court of Appeals recently affirmed dismissal of all counts of a complaint based on this fact pattern in its recent opinion in *Tow v. Bulmahn (In re ATP Oil & Gas Corp.)*.[2]

The result seems to be almost unthinkable. Dividends paid even years before a bankruptcy filing typically are viewed with suspicion. The bankruptcy here was not a huge surprise: The company was in a two-year death spiral from the highly public Deepwater Horizon environmental disaster. Nor was this solely a liquidity crisis where, with the breathing spell of chapter 11, creditors would be paid in full, so dividends did not affect creditor recoveries. To the contrary, the company was in such bad financial shape that it could not restructure in chapter 11 and converted its bankruptcy case to a chapter 7 liquidation. How could claims concerning the approving of dividends on the eve of bankruptcy not even survive a motion to dismiss?

This article briefly sets forth the facts of the case, then explores what seems (on its face) to be the causes of action that might have provided the easiest path to claims that should have survived dismissal, but appear not to have been raised. Finally, the article explores and critiques the court's holding that the dividends did not state a claim for breach of fiduciary duty.[3]

## Relevant Facts

ATP was an oil and gas development and production company whose largest operations were in the Gulf of Mexico. After the Deepwater Horizon accident in 2010, ATP faced significant regulations that increased its cost of drilling and the decommissioning of wells. The bad news only got worse when new estimates showed that the North Sea Cheviot Field, in which ATP had deployed a floating production platform, contained only a fraction of the originally estimated $702.5 million in proven undeveloped reserves. ATP was unable to secure drilling licenses in the Eastern Mediterranean, despite millions of dollars in outlays, due to seizure by the Israeli government caused by violations of Israeli law. ATP tried to remain afloat by selling "net profit increases" and overriding royalty interests to improve its cash flow, but this dampened its ability to profit from production and significantly encumbered its reserves.

ATP was considering bankruptcy by the summer of 2012.[4] Nevertheless, on July 2, 2012, ATP declared and paid a special dividend of $1.99 per share to its Series B stockholders. The complaint alleged that this was specifically against the advice of its attorneys.[5] On Aug. 17, 2012, less than six weeks after the dividend was declared and paid, ATP filed a chapter 11 case. The case was converted

1 The views herein are those of the author and not necessarily of Richards, Layton & Finger, PA or its clients. Mr. Silberglied thanks Katherine Devanney and **Brian Yu** of Richards, Layton & Finger, PA for research assistance in preparing this article.

2 2017 WL 4876310 (5th Cir. Oct. 27, 2017) (the "Opinion" and together with the district court opinion, the "Opinions").

3 The Opinion also affirms dismissal of claims that bonuses paid to officers shortly before bankruptcy were breaches of fiduciary duties or fraudulent transfers. This aspect of the Opinion also is interesting, but due to space constraints, this article focuses on the dividend aspect of the Opinion.

4 *Tow v. Bulmahn*, 2016 WL 1722246, at *2 (E.D. La. April 29, 2016) (the "District Court Opinion").

5 *Id.*

to chapter 7 in June 2014, and Rodney Tow was appointed the chapter 7 trustee.

The trustee filed a suit against the officers on behalf of ATP's estate. The district court granted a motion to dismiss with leave to only replead certain claims.[6] In subsequent opinions, the court dismissed those remaining claims as well.[7]

## The "Missing" Claims

The trustee challenged the payment of the dividends as being a breach of the directors' and officers' fiduciary duties. Perhaps more interesting is what appears not to have been pleaded by the trustee: a claim against the directors under Tex. Bus. Corp. Act Ann. § 21.316 (the "Texas Dividend Statute") and a fraudulent-transfer theory.

The Texas Dividend Statute, titled "Liability of Directors for Wrongful Distributions," imposes liability against directors who approve a "distribution" — which includes a dividend[8] — in excess of what is permitted under § 21.303. In turn, § 21.303 states that "a corporation may not make a distribution if the corporation would be insolvent after the distribution." Many states have similar statutes.[9]

This seems to be the most direct legal theory to address any impermissible dividend, but it was not pleaded. In addition, while the trustee pleaded that certain officer bonus payments were fraudulent transfers, for reasons unexplained (perhaps because the directors and officers were not the only transferees and therefore other defendants would have had to be added), he did not plead that the dividends were fraudulent transfers. A dividend paid while a company is insolvent would, on its face, ordinarily check all of the boxes for the case in chief for a constructively fraudulent transfer because shareholders do not provide reasonably equivalent value, or any value, for a newly issued dividend.

While not stated in the opinions, it is certainly possible that the courts were hesitant to apply fiduciary-duty principles to the allegedly wrongful dividend, when the path to recovery already appeared to have been available through two different statutes. After all, courts often are wary of employing fiduciary duty law as a "gap filler" when other areas of law already address the subject, and it is not clear that any gaps existed that needed to be filled.[10]

## Dividend Payments Held to Harm the Creditors, Not the Corporation

In affirming the dismissal of counts that argued that approving and paying the dividend was a breach of fiduciary duty, the Fifth Circuit rejected several arguments of note. Perhaps most importantly, the Fifth Circuit summarily affirmed a more detailed ruling of the district court: The directors only owed a fiduciary duty to the corporation itself — not its creditors — and the trustee failed to plead how the corporation itself was damaged by paying the dividend.[11] The district court noted a series of the complaint's allegations that the corporation was actively considering bankruptcy when it declared and paid the dividend, and that it received attorney advice that issuing dividends at that time would be "improper."[12] The court held that:

> [T]hese allegations suggest that ATP's creditors may have been harmed by distributions that ATP made in its last days as a going concern. But the Trustee does not plead any facts tending to show that the eleventh-hour payment, made on the eve of ATP's bankruptcy filing, harmed the corporation itself.[13]

Two aspects of this holding are undeniably true, but in the author's view, the conclusion is not. Under many states' laws, directors do not owe fiduciary duties directly *to creditors*, even when a corporation is insolvent, but they continue to owe fiduciary duties to the corporate entity.[14] In addition, it is certainly true that creditors are harmed when an insolvent corporation dividends precious cash to stockholders; every dollar paid to stockholders of an insolvent corporation is one fewer dollar left to satisfy the insolvent corporation's creditors.

However, it does not necessarily follow that the corporation itself is not harmed as well. Both opinions noted that ATP was cash-starved and deploying numerous cash-saving strategies.[15] In other aspects of the opinions, both courts rejected claims that those cash-saving strategies were a breach of fiduciary duty, instead holding that the strategy was a cognizable one that was protected by the business-judgment rule.[16] Dividending cash to stockholders runs exactly contrary to the cash-saving strategy.

If the cash-saving transactions really were necessary to protect the corporation's best interests, it is difficult to see how spending cash on a dividend did not harm the corporation itself and not just its creditors. More generally, if utilizing precious cash to make an unnecessary payment jeopardizes the corporation's ability to pay valid legal obligations of the corporation, this seems to be a quintessential corporate harm.

## The Complaint's Lack of Specificity

The Fifth Circuit also held that the district court properly dismissed the claim that authorizing the dividends violated fiduciary duties because:

> [T]he Trustee fails to allege with specificity which Appellees authorized the preferred stock dividend payment. That is, the Trustee fails to distinguish between the different roles and responsibilities of officers and directors. The court cannot reasonably infer which defendants are liable for the alleged misconduct, so the Trustee's claims lack facial plausibility.[17]

One can be sympathetic to the Fifth Circuit's frustration with what apparently was imprecise pleading (especially in a third amended complaint), but this holding is problematic for a few reasons.

6 *Id.* at *30.
7 *See* Opinion at *5-6; *Tow v. Bulmahn*, 565 B.R. 361, 367 (E.D. La. Jan. 4, 2017).
8 *See* Tex. Bus. Corp. Act Ann. § 21.002(6)(A)(i).
9 *See, e.g.*, 8 Del. C. § 174.
10 *See, e.g., Prod. Res. v. NCT Grp.*, 863 A.2d 772, 790 (Del. Ch. 2004) ("With [already existing statutory] protections, when creditors are unable to prove that a corporation or its directors breached any of the specific legal duties owed to them, one would think that the conceptual room for concluding that the creditors were somehow, nevertheless, injured by inequitable conduct would be extremely small, if extant.").
11 Opinion at *3 (citing District Court Opinion at *10).
12 District Court Opinion at *10.
13 *Id.*
14 *See Conway v. Bonner*, 100 F.2d 786, 787 (5th Cir. 1939) (applying Texas law); *N. Am. Catholic Educ. Programming Found. Inc. v. Gheewalla*, 930 A.2d 92, 100-01 (Del. 2007) (Delaware law).
15 District Court Opinion at *3; Opinion at *1.
16 District Court Opinion at *19-20; Opinion at *4.
17 Opinion at *4.

First, the district court opinion specifically states that the complaint pleads that the CEO and chairman of the board "caused ATP to issue a preferred stock dividend.... The remaining defendants acquiesced to his demands."[18] At a minimum, that is a specific allegation against one defendant, yet the court affirmed dismissal against all defendants on this ground.

Second, the Texas statute, like the statutes of most states, sets forth who has to authorize dividends: the board of directors.[19] Unless someone abstained from voting or voted against the dividend — which assumes the opposite of the complaint's allegation that all defendants acquiesced — it ought to be readily ascertainable who authorized the dividends: all directors.

Third, while the Fifth Circuit cited the U.S. Supreme Court's *Iqbal*[20] opinion in support of the passage above, it is not clear that its interpretation is actually consistent with *Iqbal*. *Iqbal*, together with the two other Supreme Court cases decided two years earlier,[21] created a new "plausibility" standard. However, those opinions did not suddenly require pleading with "specificity" or "particularity" for non-fraud claims. As the Seventh Circuit has phrased it, the Supreme Court "has insisted that it is not requiring fact pleading, nor is it adopting a single pleading standard to replace Rule 8 [and] Rule 9."[22] Unlike Rule 9, which requires pleading fraud claims with specificity, other claims still only require notice pleading.[23] Thus, the fact that "the Trustee fail[ed] to allege *with specificity* which Appellees authorized the preferred stock dividend payment"[24] arguably should not be determinative.

## Application of the Business-Judgment Rule

The Fifth Circuit held that in applying the business-judgment rule, "[c]ourts typically do not intervene in corporate affairs unless officers or directors commit acts that are *ultra vires*, fraudulent, or oppressive to minority shareholders."[25] There are interesting issues beyond the scope of this article concerning the use of this formulation of the business-judgment rule when the complaint alleges that certain defendants were stockholders and therefore beneficiaries of the dividend. However, one thing stands out.

Generally, the law is that a dividend is *ultra vires* if declared and paid when a corporation is insolvent or lacks capital.[26] Thus, even under the standard that the Fifth Circuit articulated, the court should have considered whether paying the dividend when the company was insolvent rendered the protections of the business-judgment rule inapplicable.

## Conclusion

The Fifth Circuit's affirmance of dismissal of a challenge to dividends paid six weeks before a bankruptcy filing is surprising. The facts that the company was so far insolvent that it eventually converted to a chapter 7 case and that corporate counsel specifically advised against the dividend but it was declared and paid anyway make the fact that discovery was not even permitted all the more unusual.

The aspects of the opinion are problematic, but the biggest moral of the story might be not to ignore the causes of action that most directly remedy the harm at issue in favor of broad fiduciary duty-based theories. Had the trustee pleaded causes of action under the Texas Dividend Statute and Uniform Fraudulent Transfer Act, the result of the case might have been different. abi

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18 District Court Opinion at *7.
19 Tex. Bus. Corp. Act Ann. § 21.310.
20 *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).
21 *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); *Erickson v. Pardus*, 551 U.S. 89 (2007).
22 *Swanson v. Citibank NA*, 614 F.3d 400, 404 (7th Cir. 2010).
23 *Id.*
24 Emphasis supplied.
25 Opinion at *3.
26 *See, e.g., Hamor v. Taylor-Rice Eng'g Co.*, 84 F. 392, 397 (C.C.D. Del. 1897); *Benas v. Title Guar. Trust Co.*, 267 S.W. 28, 33 (Mo. Ct. App. 1924); *see also Brown v. Byrne*, 75 S.W.2d 484, 486 (Tex. App. 1934) (citing with approval cases holding that such acts are *ultra vires*).