

# International Corporate Rescue



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### *Burnden Holdings (UK) Ltd v Fielding* [2018] UKSC 14

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#### Synopsis

In *Burnden Holdings (UK) Ltd v Fielding*, the Supreme Court provided clear guidance regarding the application of section 21(1)(b) of the Limitation Act 1980 to company directors. In short, in contrast with express trustees, it now appears that for the purposes of section 21(1)(b) a company director will generally be treated as having ‘previously received’ trust property or the proceeds of trust property by virtue of being the fiduciary steward of the company’s property, such that the focus of the Court’s attention under the sub-section will principally be whether the property was ‘converted to his use’.

#### Company Directors and section 21 of the Limitation Act

In what circumstances will no period of limitation under the Limitation Act 1980 run against a company director who has acted in breach of his or her fiduciary duties? A number of recent Court of Appeal decisions have considered different aspects of this vexed issue in recent times.<sup>1</sup> In *Burnden Holdings (UK) Ltd v Fielding* [2018] UKSC 14, the Supreme Court recently provided clear and welcome guidance in relation to the application of section 21(1)(b) of the Limitation Act to company directors.

Insofar as relevant, section 21 of the Limitation Act provides:

‘21 (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action –

- (a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
- (b) to recover from the trustee trust property or the proceeds of trust property in the possession of

the trustee, or previously received by the trustee and converted to his use.

[...]

(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued. For the purposes of this subsection, the right of action shall not be treated as having accrued to any beneficiary entitled to a future interest in the trust property until the interest fell into possession.’

Pursuant to section 38(1) of the Limitation Act, the terms ‘trust’ and ‘trustee’ have the same meanings as in the Trustee Act 1925. The broad definitions of ‘trust’ and ‘trustee’ under section 68(17) of the Trustee Act 1925 encompass constructive trusts. By way of relevant legal background, it is now well established that there are two types of constructive trustee for the purposes of limitation.<sup>2</sup> In *Paragon Finance plc v D B Thakerar & Co* [1999] 1 All ER 400, Millett LJ drew a frequently cited distinction between, on the one hand, a constructive trustee who owes pre-existing duties in respect of trust property pre-dating any breach of duty (a so-called ‘Class 1 constructive trustee’) and, on the other, a constructive trustee who only becomes such by virtue of having committed some wrongdoing (a ‘Class 2 constructive trustee’).

In *JJ Harrison v Harrison* [2002] BCLC 162, the Court of Appeal accepted that there was ‘no doubt’ that a company director is properly treated as Class 1 constructive trustees for limitation purposes because a director, on appointment:

‘assumes the duties of a trustee in relation to the company’s property. If, thereafter, he takes possession of that property, his possession ‘is coloured from

#### Notes

- 1 In particular, see the recent Court of Appeal decision in *First Subsea Ltd (formerly BSW Ltd) v Balltec Ltd* [2017] EWCA Civ 186 in relation to section 21(1)(a) of the Limitation Act.
- 2 This twofold categorisation was confirmed by the Supreme Court in *Williams v Central Bank of Nigeria* [2014] AC 1189 at [9] and [28]. See also *Peconic Industrial Development Ltd v Lau Kwok Fai* [2009] 5 HKC 135, a decision of the Hong Kong Court of Final Appeal in relation to the statutory equivalent of section 21, per Lord Hoffmann.

the first by the trust and confidence by means of which he obtained it'. His obligations as a trustee in relation to that property do not arise out of the transaction by which he obtained it for himself. The true analysis is that his obligations as a trustee in relation to that property predate the transaction by which it was conveyed to him.<sup>3</sup>

It is apparent from some of the cases in this area<sup>4</sup> that section 21 has been applied to company directors *by analogy*, as permitted by section 36(1) of the Limitation Act. But in *First Subsea Ltd (formerly BSW Ltd) v Balltec Ltd* [2017] EWCA Civ 186S, Patten LJ (with whom Kitchin and Briggs LJJ agreed) considered that a director is actually a 'trustee' within the extended definition of section 38(1) of the Limitation Act, and that section 21 is accordingly directly applicable to claims made against a director for breaches of fiduciary duty.<sup>5</sup>

In general, therefore, a director who has acted in breach of fiduciary duty will be able to rely on section 21(3) of the 1980 Act, under which a 6-year limitation period applies, unless the breach falls within section 21(1) of the 1980 Act, which disapplies any statutory limitation period in the case of fraud or fraudulent breach of trust to which the director was party (section 21(1)(a)), or where company property is in the possession of the director, or was previously received by the director and converted to his own use (section 21(1)(b)).<sup>6</sup>

## First Instance and the Court of Appeal

In *Burnden v Fielding* itself, the limitation issue arose in the following way. On 12 October 2007, with a view to selling a shareholding in one of the claimant company's wholly-owned subsidiaries, the claimant's directors authorised the distribution *in specie* of the shares in the subsidiary to a Newco of which they were the majority shareholders and directors. By a number of additional transactions, the shares were transferred on to a further holding company, and the directors' shareholdings in that entity were, in turn, sold to a third party purchaser for GBP 6 million.

The claimant company went into liquidation in 2009. Proceedings against the directors were issued on 15 October 2013. It was alleged that the distribution *in specie* of the shares in the subsidiary was an unlawful distribution, amounting to a breach of fiduciary duty to which the directors were party. Though hotly contested in the main proceedings, it was assumed for the purposes of the summary judgment application that

followed and the limitation arguments that this was indeed the case. *Prima facie*, therefore, the limitation period applicable to the directors was six years pursuant to section 21(3), subject to the contrary provisions of the Limitation Act. It was agreed that six years and three days had elapsed from 12 October 2007 by the time the claim form was issued, such that the claim would have been time-barred if section 21(1) or section 32 (deliberate concealment of a cause of action) did not apply.

At first instance, HHJ Hodge QC held that the claim brought by the claimant for alleged breach of duty against the two directors was time-barred, and summary judgment was entered in favour of the defendant directors. The Court of Appeal disagreed and upheld the claimant's appeal on the basis that limitation did not run against the claimant by virtue of section 21(1)(b) of the Limitation Act. The Court of Appeal considered that, on its proper construction, section 21(1)(b) included within its terms a transfer to a company directly or indirectly controlled by the trustee, such that no limitation period applied to the claimant's claim. David Richards LJ said at [37]:

'If section 21(1)(b) were construed to apply only to those cases where the trustee directly and personally acquires the trust property, its evident purpose would be much constrained and easily avoided. In my judgment, a construction which includes within its terms a transfer to a company directly or indirectly controlled by the trustee is within the meaning of this provision.'

Alternatively, the Court of Appeal held that the claimant was entitled to succeed on the basis of section 32 of the Limitation Act, given that it was not possible, in the context of summary judgment, to determine when the claimant could have discovered the directors' breach with reasonable diligence.

## The Supreme Court's judgment

By the time the appeal had reached the Supreme Court, it was accepted that there could no longer be summary judgment for the defendant directors, because the claimant had (after permission to appeal had been granted) amended its statement of claim to allege that the unlawful distribution amounted to a fraudulent breach of trust to which the defendants were a party, thereby engaging section 21(1)(a) of the Limitation Act. Nevertheless, the issue as to the meaning of

### Notes

3 At paragraph 29.

4 See for example, Mummery LJ's judgment in *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 BCLC 131.

5 At paragraph 50.

6 A defaulting director may, of course, also rely on section 32 of the Limitation Act.

section 21(1)(b) was of sufficient importance to have made it appropriate for the appeal to proceed.

In the Supreme Court, the defendants' principal contention was that the relevant trust property (the shareholding in the subsidiary) was never in the possession of the directors, nor had it been previously received by them and converted to their own use within the meaning of section 21(1)(b); rather the shareholding had been in the ownership and possession of the claimant and thereafter a succession of different corporate entities. To ignore that the shareholding was transferred to a succession of corporate entities – and not to the directors themselves – involved impermissibly lifting one or more corporate veils.

Giving the Court's unanimous judgment, Lord Briggs considered that the starting point was the purpose of section 21(1)(b). In that connection, his Lordship approved the statement of Kekewich J in *In re Timmis, Nixon v Smith* [1902] 1 Ch 176 in respect of section 21(1)(b)'s statutory antecedent:

'The intention of the statute was to give a trustee the benefit of the lapse of time when, although he had done something legally or technically wrong, he had done nothing morally wrong or dishonest, but it was not intended to protect him where, if he pleaded the statute, he would come off with something he ought not to have, i.e., money of the trust received by him and converted to his own use.'

Second, Lord Briggs noted that it was necessary to bear in mind that section 21 was primarily aimed at express trustees and applicable to company directors 'by what might fairly be described as a process of analogy' (compare *First Subsea Ltd v Balltec Ltd* at [50] above). Whereas express trustees might or might not from time to time be in possession or receipt of trust property, directors of a company are necessarily treated as being in possession of the trust property from the outset because they are the fiduciary stewards of a company's property (paragraphs 18 to 19). Thus it followed that:

'if [the directors'] misappropriation of the company's property amounts to a conversion of it to their own use, they will still necessarily have previously

received it, by virtue of being the fiduciary stewards of it as directors.

It may well be that, in relation to trustees who are company directors the requirement in section 21(1)(b) that the property be received by them before its conversion adds little or nothing to the conditions for the disapplication of any limitation period which would have operated in their favour' (paragraphs 19 to 20).

Third, on the assumed facts, the defendant directors converted the claimant company's shareholding in the subsidiary when they procured or participated in the unlawful distribution of it to the Newco. It was a conversion because it was a taking of the company's property in defiance of the company's rights of ownership of it. It was a conversion to their own use, because of the economic benefit which they stood to derive from being the majority shareholders in the company to which the distribution was made. Lord Briggs concluded at paragraph 22: '[b]y the time of that conversion the defendants had previously received the property because, as directors of the claimant company, they had been its fiduciary stewards from the outset.'

Accordingly, the appeal in relation to section 21 was dismissed, albeit the Supreme Court's analysis differed to some extent from the Court of Appeal's reasoning. The appeal in relation to section 32 was dismissed on the basis that it was unsuitable for summary judgment because there would still be fact-intensive issues calling for trial. Lord Briggs expressed no view on the correctness or otherwise of the analysis adopted by the Court of Appeal in respect of section 32(2) of the Limitation Act.

In light of this decision, it now appears that, in general, company directors will be treated as having 'previously received' trust property for the purposes of the second limb of section 21(1)(b) of the Limitation Act by virtue of having assumed fiduciary obligations in respect of company property from the time of entering office, such that, in the main, the court's focus will be on whether the directors converted company property to their own use.

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