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Burnden Holdings (UK) Ltd (in liquidation) v Fielding [2019] EWHC 1566 (Ch)

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Synopsis

In *Burnden Holdings (UK) Ltd v Fielding* in what was a pragmatic and commercial judgment, the High Court provided guidance on a number of important legal issues including directors' duties, unlawful distributions and transactions defrauding creditors. In dismissing all claims, the Court found, amongst other matters, that (i) directors who reasonably rely on properly prepared financial accounts will not be found to have made an unlawful distribution, (ii) the payment of a dividend can be a transaction at an undervalue (but the granting of security over existing indebtedness cannot be), and (iii) section 1157 relief is not precluded in relation to unlawful distributions in circumstances where a company subsequently goes into liquidation.

Introduction: years of litigation come to an end

The case involves two transactions which took place in 2007.

a) The first transaction involved Burnden Holdings (UK) Ltd ('BHUK') granting security to Mr and Mrs Fielding, who were both shareholders of the Burnden group and directors of BHUK (the 'Fieldings'), in the form of a fixed and floating charge in exchange for loans provided by the Fieldings to BHUK (the 'Grant of Security').

b) The second transaction was in relation to a demerger of Vital Energy Utilities Limited ('Vital'), a subsidiary of BHUK (the 'Demerger'). The Demerger involved a distribution in specie by BHUK of its entire shareholding in Vital, the ultimate result of which was Vital's separation from the rest of the Group (the 'Distribution').

In 2009, BHUK entered into liquidation. In 2013, the liquidator of BHUK brought an action against the Fieldings, contending that:

a) the Grant of Security was a *transaction defrauding creditors* within the meaning of section 423 of the Insolvency Act 1986 (the 'IA 1986') and a dishonest breach of the Fieldings' fiduciary duties as directors of BHUK;

b) the Distribution was unlawful and in breach of the Fieldings' fiduciary duties as directors of BHUK mainly because it did not meet the formalities and requirements of section 263 and section 270 the Companies Act 1985 in relation to declaring a dividend;[1] and

c) the Distribution was a dishonest breach of the Fieldings' directors' duty to take into account the interests of creditors under section 172(3) of the Companies Act 2006; and

d) the Distribution was a transaction defrauding creditors within the meaning of section 423 of the IA 1986.

A summary judgment application in relation to certain matters concerned with the application of the Limitation Act 1980 followed. This was ultimately dismissed by the Supreme Court in 2018 allowing the BHUK liquidator's action to proceed and does not form part of this article.[2]

On 19 June 2019, the High Court handed down its judgment in *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 1566 (Ch), in relation to the substance of the alleged claims brought against the Fieldings. The court dismissed all claims against the Fieldings arising in relation to the two transactions, bringing to an end six years of litigation.

Notes

1 The claim was under the provisions of the Companies Act 1985 as certain provisions relating to distributions in the Companies Act 2006 did not come into force until 6 April 2008, and the relevant distribution occurred in 2007. See section 1300 of the Companies Act 2006.

2 See Eduardo Lupi, Burnden Holdings (UK) Ltd v Fielding [2018] UKSC 14 (2019) 16:1 *International Corporate Rescue* 60.

Statutory requirements relating to distributions

The Companies Act 1985 (which for the purposes of distributions is in largely similar terms to the Companies Act 2006 now in force) requires that certain conditions be met in order to lawfully declare and pay a dividend. Here, the contention was that two provisions were not complied with. First, under section 263, a company can only make a distribution out of *sufficient distributable profits*. Second, under section 270, the amount of any distribution is to be determined by reference to certain items in a company's annual accounts in the first instance (i.e. profits, losses, assets and liabilities), and then with reference to any interim accounts where necessary for a 'reasonable judgment' to be made as to those items.

The liquidator's most substantial argument was that certain items were substantially overvalued in, and certain liabilities wrongfully excluded from, the interim accounts, thereby wrongfully identifying the distributable profits available to BHUK. Accordingly, the liquidator argued that the directors were unable to form a reasonable judgement as to BHUK's assets and liabilities as required by law.

After an extensive review of fact specific accounting matters, the Court noted that, despite the apparent overvaluation and wrongful exclusions, the interim accounts were properly prepared by BHUK's auditors and internal finance team, and showed a sufficient distributable profit to make the distribution. Accordingly, the Court concluded that it was reasonable for the directors to rely on their auditors and legal advisors to ensure the Distribution was lawful.[3] The Court further noted that while interim accounts are expected to be prepared to a high standard and allow a reasonable judgement to be made, private companies are not expected to meet the 'true and fair view' requirements that public companies must meet with respect to interim accounts.

Unlawful distribution

While Zacaroli J found that the Distribution was lawful, he went on to consider whether the directors would have been liable for breach of duty had the Distribution been found to be unlawful. After an extensive review of authorities, the Court found that the directors had appropriately relied on the advice of their professional advisors and accordingly could not be found to be in breach of their duties.

With respect to the legal position, the Court concluded that directors' liability in respect of an unlawful dividend is *fault-based* and not strict. In so ruling, the Court brought much needed clarity to an area of law which has historically produced notably conflicting authority. In summary, a director is liable if she or he:

a) knew, or ought to have known (as a reasonably competent and diligent director), that the dividend was unlawful; or

b) knew (or must be taken in all the circumstances to have known) of the facts that established the unlawful dividend (whether or not they were aware such facts meant that the dividend was unlawful).[4]

Importantly, the Court made clear that, in circumstances where a director was unaware of the facts which rendered a dividend unlawful, he or she is able to rely on the judgement of financial advisors and properly prepared financial accounts when it comes to deciding whether or not to declare a dividend. Provided directors have taken reasonable care to secure the preparation of financial accounts which establish the availability of sufficient profits and it is reasonable to rely on those accounts, then they will not be personally liable if it turns out, unbeknown to the directors, that the profits were in actual fact insufficient.[5]

This is a welcome confirmation of the commercial reality of dividend distributions and will provide some reassurance for directors when deciding whether to declare a dividend.

Creditors' interest duty

Under section 172(3) and as recently decided, when a director knows or ought to know that the company is or is likely to become insolvent (where 'likely' means probable) the focus of the director's attention must shift away from considering the interests of the shareholders and towards considering and protecting the interests of creditors (the 'Creditors' Interest Duty').[6] The liquidator contented that the Distribution was a dishonest breach of the Creditors' Interest Duty.

Given BHUK was a holding company, the Court considered the balance sheet test as the appropriate test to apply in considering BHUK's solvency. In rejecting the liquidator's claim, the Court applied the test set out in *Eurosail*.[7] The Court emphasised that amounts recorded in the financial statements may be evidential regarding the question of solvency but are not conclusive. The

Notes

3 *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 1566 (Ch) at [327], [329], [338].
4 Ibid [148].
5 Ibid [139].
6 Ibid [343]; *BTI 2014 LLC v Sequana S.A.* [2019] EWCA Civ 112 at [220].
7 *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc* [2013] 1 WLR 1408

Court further reaffirmed a number of key tenets of balance sheet insolvency, including:

a) the real or commercial value of assets needs to be considered;

b) in considering a company's contingent and prospective liabilities, 'proper allowance' is to be made 'discounted for contingencies and deferment'; and

c) the financial situation of a corporate group where a subsidiary within the group is insolvent should not be conflated with the solvency of the parent.[8]

Transactions defrauding creditors

Insofar as relevant, section 423 IA 1986 stipulates that a person enters into a transaction defrauding creditors with another person if such person:

a) 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 themselves; and

b) the court is satisfied that such transaction was entered into for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against them, or otherwise prejudicing the interests of such a person in relation to the claim which they are making or may make.

The Court, following *Sequana* emphasised that the payment of a dividend will ordinarily constitute a transaction at an undervalue within the meaning of section 423.[9] The question in the present case therefore turned on the other limbs of section 423, namely whether a real substantial purpose (rather than sole or dominant purpose) of the Distribution was to put the shares 'beyond the reach' of creditors.[10]

The Court noted that prejudice to creditors is more likely if a company's solvency is affected by a transaction, so knowledge of insolvency may therefore be a factor.[11] However, on the facts, the liquidator's claim failed. There was a clear, well considered and documented commercial rationale for the Demerger. Vital's business was different to the rest of the Group, had a different market culture, there were no synergies from Vital being part of the Group and Vital would be more successful once separated. Accordingly, the real substantial purpose of the Distribution was not to put the Vital shares beyond creditors' reach, but to effect a commercially reasonable transaction.

In relation to the Grant of Security, the liquidator contended that the Grant of Security was either a transaction entered into for no consideration or for consideration which was significantly less than that provided by BHUK. The Court considered itself bound by *Re MC Bacon,* emphasising that a comparison must be made 'between the value obtained by the company, and the value of consideration provided by the company (...) and with both being considered from the company's point of view'.[12] In granting security for existing indebtedness, all that the company has lost is the ability to apply the proceeds of an asset otherwise than in satisfaction of the secured debt (always subject to its ability to redeem the security by paying the debt) and that is not something capable of valuation in monetary terms. The Court declined to follow Arden LJ's opinion in *Hill v Spread Trustee* where she considered that 'there seems to be no reason why the value of the right to have recourse to the security and to take priority over other creditors, which the debtor creates by granting the security, should be left out of account.' The Court here addressed those comments head on, stating that *MC Bacon* provided a reason why that value should be left out of account, namely that it has a value only from the point of view of the *creditor,* whereas the section requires value given and received to be viewed from the *company*'s point of view.

Relief for breach of duty

The Court also provided some helpful guidance *obiter* in relation to its discretion to grant relief to directors for breach of duty under section 1157 of the Companies Act 2006 (although not deciding whether such relief would have been granted in the present case as it was unnecessary to do so). Zacaroli J noted that while the Fieldings' receipt of the allegedly unlawful dividend and BHUK going into subsequent liquidation is a 'powerful factor' against granting relief, the Court's discretion was not entirely fettered in such circumstances.[13] Three factors were noted as relevant in deciding whether to preclude relief being granted.

a) First, the 'causal link' between the dividend and prejudice to creditors.

b) Second, the time between the dividend and any action being commenced.

Notes

8 *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 1566 (Ch) at [351], [352].
9 *Burnden Holdings (UK) Ltd v Fielding* [2019] EWHC 1566 (Ch) at [403]; see *BTI v Sequana* [2019] EWCA Civ 112 at [63].
10 Ibid [404]; *IRC v Hashimi* [2002] BCC 943 at [23]-[25].
11 Ibid [405].
12 Ibid [503].
13 Ibid [413].

c) Third, whether the benefit of an alleged unlawful dividend is retained by the relevant director.

The takeaway for directors is that, while relief under section 1157 is not precluded in relation to unlawful distributions in situations where a company subsequently goes into liquidation, the Court will likely be reluctant to grant relief in such circumstances. That said, relief will ultimately continue to be assessed on a case by case basis and *Burnden* has helpfully provided some added guidance in relation to relevant considerations.

Comment

The wide ranging decision in *Burnden*, while not providing any significant legal development to the status quo when it comes to directors duties, unlawful distributions and transactions defrauding creditors, has helpfully affirmed and clarified key aspects of each of these areas of law.

Reassuringly, it is business as usual for directors when it comes to declaring dividends, as the Court's decision in relation to distributions was pragmatic and commercial. That being said, given the level of scrutiny the Court gave to analysing the intricacies of the company's accounts and the directors' considerations (in a judgment running to more than 100 pages), directors should, as always, take all precautions to ensure accounts are appropriately prepared and accurate, make relevant further inquiries where necessary, and ultimately act reasonably when considering interim accounts.

In relation to transactions at an undervalue, it is interesting that the Court gave *MC Bacon* a boost in terms of its precedential weight – following its rationale and refusing to follow *Hill v Spread Trustee* despite that case being from a higher court, the Court of Appeal. This was both because the Court considered itself bound by *MC Bacon* (finding that it was not plainly wrong) and because the Court endorsed the logic expressed by Millett J (as he then was) in *MC Bacon*.

International Corporate Rescue

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