This article was first published in Greens Business Law Bulletin, Issue 157 (published December 2018) and on http://www.westlaw.co.uk. It is reproduced here with the kind permission of Thomson Reuters

****

Directors as financial stewards and conversion of company property
***Burnden Holdings (UK) Ltd (in liq) v Fielding* [2018] 2 W.L.R. 885**

Andrew Bowen *QC*

Introduction

The issue in *Burnden* was the nature of a director's proprietary interest in the company's shares, which had been transferred to another company on the assumption (strongly denied by the defendant directors) that the transfer had been in breach of trust. Although the issue arose in the context of English limitation law (the commercial prescriptive period is six, rather than five, years), the Supreme Court's treatment of a director's interest will be authoritative in Scotland in relation to both director's duties and prescription.

The law

Section 21(1)(b) of the Limitation Act 1980 ("the 1980 Act") disapplies the normal six year English limitation period for an action by a beneficiary under a trust where the action relates either to fraud or fraudulent breach of trust to which the trustee was a party or privy, or an action 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 their use. Directors of a UK company who are assumed to have participated in a misappropriation of an asset of the company are to be regarded for all purposes connected with s.21 as trustees because they are entrusted with the stewardship of the company's property and owe fiduciary duties to the company (*Williams v Central Bank of Nigeria* [2014] A.C. 1189, at [28] per Lord Sumption JSC). The company is the beneficiary of the trust for all purposes connected with s.21(1)(b) of the 1980 Act. Section 32 of the 1980 Act defers the prescriptive period where there has been a deliberate concealment of (in this case) the breach of duty.

In *Miller v Bain* [2002] 1 B.C.L.C. 266, the first instance judge had held that where a fiduciary (a director) used his beneficiary's (company) money to confer a benefit on a different company he controlled, he was converting it to his own use since he was, in effect, denying the beneficiary's title to that money so he was to be regarded as having received that trust property, even though he had not received that money himself.

The obligations of a trustee to make reparation or restitution in respect of any fraudulent breach of trust to which the trustee was a party or was privy or to make furthcoming to any person entitled thereto any trust property, or the proceeds of any such property, in the possession of the trustee, or to make good the value of any such property previously received by the trustee and appropriated to their own use are likewise imprescriptible (Prescription and Limitation (Scotland) Act 1973 Sch.3 para.(e)). A director is a trustee for this purpose (*Dryburgh v Scotts Media Tax Ltd*, 2014 S.C. 651 at [121]).

The facts

The defendants, Mr and Mrs F, were directors, and controlling shareholders, of the claimant BH Ltd, which was the holding company of a group of trading subsidiaries operating a conservatory business and a power business, V Ltd. In 2007 a major power company, SSE, offered to buy a 30 per cent shareholding in V Ltd for £6m, subject to the condition that the power business was completely separated from the conservatory business, which had been struggling financially. After taking advice from legal, restructuring and tax advisers, the defendants transferred their shares in the claimant to a new holding company, BHUH Ltd. A week later the claimant declared a dividend in favour of BHUH Ltd; as the former did not have sufficient distributable profits, it created a revaluation reserve of its shareholding in V Ltd at £10m and distributed *in specie* that shareholding, which was approved by a unanimous resolution of the claimant's directors (the defendants) and by a resolution in writing of BHUH Ltd as the sole member of the claimant. The distribution was effected with the registration in V Ltd's register of members of the transfer of the shares from the claimant to BHUH Ltd. BHUH Ltd then went into members' voluntary liquidation and the liquidator transferred the shares in V Ltd to a new company, VHL Ltd and the shares in the claimant to a new company, Burnden Group Holdings Ltd ("BGHL"), effecting the separation of the two businesses. The two new holding companies issued shares to the former shareholders in BHUH.

The defendants then sold a 30 per cent shareholding in VHL Ltd to SSE for £6m. Shortly after, the claimant went into liquidation. The claimant's liquidator alleged that the distribution *in specie* of the claimant's shareholding in V Ltd to BHUH was not in its best interests and unlawful, and the defendants were in breach of duty because the claimant did not have sufficient accumulated, realised profits for a lawful distribution. However, proceedings were not raised by the liquidator until six years and three days after the distribution *in specie* so the defendants argued that the claim had prescribed as it was three days outside the six years allowed to raise the action, on the usual assumptions that the distribution was unlawful, that the defendants' participation in it amounted to a breach of their fiduciary duties to the claimant and that, because the distribution was made to a company, BHUH Ltd, in which they were majority shareholders and directors, the distribution was one from which they derived a substantial benefit (all denied for the purpose of trial). The claimant's response to that prescription argument was initially based on s.32 of the 1980 Act, that the limitation period did not run during the period the defendants had deliberately concealed the breach of duty. At the first instance hearing the claimant accepted that, for the purposes of s.21, the time limit was six years. The first instance judge refused the defendants' application based on s.32 and the claimant appealed. On appeal the defendants added in an argument, based on s.21(1)(b), that they had never had personal ownership of the shareholding in V Ltd, which had remained in the possession of the various corporate entities through which it had passed, and averred that the claim was time-barred because s.21(1)(b) of the 1980 Act only applied to directors where there had been an actual transfer to them. To attribute personal ownership and possession would involve lifting one or more corporate veils, ignoring the separate legal personality of the companies concerned, which was prohibited following *Petrodel Resources Ltd v Prest* [2013] 2 A.C. 415.

The Court of Appeal ([2017] 1 W.L.R. 39)

David Richards LJ, with whom Tomlinson and Arden LJJ agreed, noted that the prescription argument was that the trust property, the claimant's shareholding in V Ltd, was never received by them since it was transferred by way of distribution *in specie* to BHUH Ltd and then VHL Ltd. As a result, it was never in the defendants' possession nor ever received by them. He said that such a literal reading of "possession" and "received" would permit trustees who transferred trust property in breach of trust for their own benefit to evade the statutory provision by the common use of companies that hold assets where the beneficial ownership of the assets was vested in the company but the entire economic benefit was available for the shareholders at [35]. In allowing the appeal he said that, in order to achieve its purpose, s.21(1)(b) had to be construed so as to include a transfer in breach of trust to a company directly or indirectly controlled by the defaulting trustee. The defendants appealed to the Supreme Court.

The Supreme Court

Lord Briggs, giving the judgment of the court, held that there was no need to rely on anti-avoidance in construing s.21(1)(b). While the deliberate use of a corporate vehicle to distance a defaulting trustee from the receipt or possession of misappropriated trust property might justify lifting the corporate veil, it would usually involve fraud.

The defenders' argument that s.21(1)(b) did not apply because the misappropriated property had remained legally and beneficially owned by corporate vehicles rather than becoming vested in law or equity in the defaulting directors would defeat its purpose, which was not intended to protect a trustee where reliance on the provision would allow him to come off with something he ought not to have, such as money of the trust received by him and converted to his own use. In the context of company property, directors were treated as being in possession of the trust property from the start of their tenure. It was precisely because the directors were the fiduciary stewards of the company's property that they were trustees within s.21(1)(b). If a director had misappropriated the company's property he might or might not be in possession of it when the action to recover it was raised but if the misappropriation amounted to a conversion of it to his own use he would necessarily have previously received it by virtue of being the financial steward, at [19]. He rejected the argument that treating individual directors as being in possession or previous receipt of company property would unfairly assume a level of control which they might in practice lack.

Taking the averments *pro veritate*, Lord Briggs concluded that the defendants had converted the claimant's shareholding in V Ltd when they had procured or participated in the unlawful distribution of it to BHUH Ltd. It was conversion because, if the distribution was unlawful, it was a taking of the company's property in defiance of the company's rights of ownership of it and it was a conversion of the shareholding to their own use because of the economic benefit which they stood to derive from being the majority shareholder in the company to which the distribution was made. By the time of that conversion they had previously received the property as directors and financial stewards of the claimant, at [22].

Conclusion

Prior to the Supreme Court hearing the claimant had amended its case to include allegations of fraud against the defendants so the prescription plea would not have resulted in the action being struck out. The court allowed the appeal because the issue as to the meaning of

s.21(1)(b) was considered of sufficient importance for consideration by that court and there is now little doubt about the director's status as a true trustee of company property and the consequent obligations. Whether the averments would be proved (and whether the advice in relation to the restructuring would be right or wrong) was a matter for trial but, if the defendants establish that the distribution had, in fact, been lawfully made out of realised profits, there is still the potential conflict in the restructured corporations between their interests as directors to promote the wellbeing of the claimant and as shareholders with an interest in V Ltd and the transfer to SSE.

Update to Case Comment in Issue 149

In *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] 2 W.L.R. 1603, the Supreme Court overturned the Court of Appeal's decision and held that the "no oral modification" clause was legally effective.