

Unlawful distributions to directors, and limitation

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The *Burden Holdings* decision

1. In Burden Holdings (UK) Limited v. Fielding [2018] UKSC 14 the Supreme Court considered the application of Section 21(1)b) of the Limitation Act 1980 to directors in the context of an allegedly unlawful distribution by a company.
2. Company assets are treated as being “*in the possession of the [director], or previously received by the [director]*” even if they always remained legally and beneficially owned by corporate vehicles rather than being in the possession of the defaulting directors personally. That is because directors are *to be treated* as being in possession, because they are entrusted under the company’s constitution with stewardship of the company’s property as fiduciaries. It is because of that stewardship that they are treated as trustees under section 21.

3PB's Analysis

3. **The facts.** The Claimant company had brought proceedings against its former directors in relation to a distribution in specie by the Company of its shareholding in a trading subsidiary. The distribution was said to be unlawful as the Company lacked sufficient distributable reserves at the time it was made. The distribution was to another company owned and controlled by the Defendants. The proceedings were issued six years and three days after the distribution.
4. The Defendants sought summary judgment on the basis that the claim was time barred, being brought more than six years after the cause of action accrued. The Claimant company resisted, relying on Sections 21(1)b) and 32 of the Limitation Act 1980.
5. **The Limitation provisions.** Section 21(1)b) provides (emphasis added):

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

...

(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 own use”

6. Section 32(1)b) provides that where any fact relevant to the claimant’s right of action has been deliberately concealed, then time will not run until the fact has been discovered or could with reasonable diligence have been discovered.¹
7. **The proceedings.** As an application for summary judgment it was assumed that the facts on which the case were based were correct. The Defendants succeeded at first instance, but that decision was then reversed by the Court of Appeal. The Defendants appealed to the Supreme Court.
8. **The section 21 issue.** The principal argument concerned the applicability of Section 21(1)b). The Defendants’ case was that the shares which were distributed were only ever held by corporate entities, and were not held by them or converted to their own use. Counsel for the Defendants submitted:
 - 8.1. Anti-avoidance did not need to be considered in construing Section 21(1)b). If trustees deliberately inserted a company between them and misappropriated assets this would be a recognised ground for lifting the corporate veil.
 - 8.2. In any event, deliberate use of a corporate vehicle to insulate trustees from fraud would in most cases fall within Section 21(1)a).

¹ This argument had been advanced by reference to the preparation of accounts which had represented that there were in fact sufficient distributable reserves.



8.3. It was wrong in principle to equate control of a company with possession of its assets.

8.4. A distribution, even in unlawful, affirmed rather than denied the company's title to that which was distributed.

9. **The Supreme Court.** The focus of the analysis was on whether the claim was an action to recover from the trustee trust property or the proceeds of trust property, within Section 21(1)b.²

10. Lord Briggs, delivering the unanimous judgement of the Court, held:

10.1. Due regard had to be paid to the purpose of Section 21(1)b). It was primarily aimed at express trustees to prevent them keeping something which they ought not to have. It was applicable by analogy to directors.

10.2. Directors were to be treated as being in possession of trust property from the outset, on account of their role as fiduciary stewards of the company's property. There was nothing in the Defendants' objection that to treat individual directors as if they were in possession of company property would unfairly assume a level of control over it which they may in practice lack, for example by being in the minority on the board. Trustees of an express trust were treated as being in possession of trust property notwithstanding that they held title jointly.

10.3. The payment of the dividend in specie, if it was an unlawful distribution, amounted to a conversion of the Claimant's property because it was in defiance of the company's rights of ownership.

10.4. It was a conversion to their own use by the directors because of the economic benefit which they stood to derive from being the majority shareholders in the company to which the distribution was

² There was no suggestion in the case that the corporate vehicle which received the shares had been deliberately used to distance the defaulting trustee from the receipt of the property.

made. It had been noted in the Court of Appeal that it was commonplace for trustees to hold such assets through companies and that in order to achieve its purpose Section 21(1)b) had to be construed so as to include within its terms a transfer to a company directly or indirectly controlled by the defaulting trustee.

11. In adopting this approach there is a clear potential for tension to arise with the concept of separate corporate identity. As was stressed in the decision this was not said to be a case in which the company was being inserted into the transaction for the purpose of avoiding liability. Such a scenario would have been susceptible to challenge under the principle of Prest v Petrodel Resources Ltd [2013] 2 AC 415 (lifting the corporate veil).

12. **The Section 32 issue.** The Claimant had also relied on Section 32 of the Limitation Act 1980. The Supreme Court reserved its position as to the correct interpretation of Section 32 but agreed with the conclusion of the Court of Appeal that it was likely to be too fact sensitive for summary judgment.

Impact of the Decision

13. This decision is of particular relevance to those dealing with the misconduct of directors, in both solvent and insolvent situations. The analysis adopted by the Supreme Court in relation to the deriving of economic benefit, rather than adopting a strict legal ownership and beneficial interest approach marks a shift towards a greater emphasis on the economic substance of transactions rather than the legal form in this context. Coupled with Prest v Petrodel Resources Ltd it demonstrates that the corporate veil is susceptible to challenge on a number of grounds. In this case, on the appeal before the Supreme Court, there was no allegation of fraud or anti-avoidance and yet by adopting an economic substance approach the court has looked through the fact that the distributed shares were held by a corporate legal person, separate from the directors.



14. The confirmation of the availability of Section 21(1)b) in cases of the misapplication of company assets such as was alleged in this case has significant practical benefits for those seeking to recover assets in circumstances such as these. Unlawful dividend payments or the misapplication of company resources to the benefit of a director or a company under his control will no longer be subject to a six year time bar. Claimants, whether office holders or companies following a change of control, will now be able to examine a broader time period of transactions to identify grounds for challenge. This is a decision likely to be of significant practical use to a broad range of potential claimants.

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This article intends to state the law at the date indicated above. Although every effort is made

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