



Commercial and Insolvency Update June 2017

First Subsea V Balltec Ltd

Introduction

It is common for claims against directors for breach of the fiduciary duties to raise issues of limitation. This is because the company may often have remained under the wrongdoing directors' control for some time after the alleged breaches of duty were committed. There will have been a marked reluctance, to say the least, on the part of the wrongdoing directors to bring claims against themselves. This arises most often in the case of liquidations where claims are brought under section 212 of the Insolvency Act 1980. Limitation for these purposes (absent one of the exceptions under the Limitation Act 1980 ("LA 1980") will run from the date of breach and not the date on which the company comes under the control of an independent office-holder with a duty to investigate and prosecute claims.

Such claims are subject to a six-year limitation period pursuant to LA 1980, s. 21(3) (claims to recover trust property or of any breach of trust) or s. 36(1) (by analogy with claims in contract or tort).

LA 1980, ss. 21(1)(a) and 32(1)(a) respectively disapply or postpone the six-year limitation periods in cases of fraud. However, there has been doubt as to who is to be taken as a "trustee" for the purposes of s. 21(1). S. 21 of the LA 1980 provides as follows:

"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."*

The recent decision of the Court of Appeal in [First Subsea Ltd v Balltec Ltd & Ors \[2017\] EWCA Civ 186](#) ("*First Subsea*") has provided clarification as to the meaning of 'trustee' in s. 21 and its application to claims against company directors for fraudulent breaches of fiduciary duty.

First Subsea explained

The appeal was made by the Second Defendant, Mr Emmett ("E"). At trial, [Norris J held](#), *inter alia*, that E was required to pay equitable compensation to the Claimant, First Subsea Ltd ("FS"), for breach of the fiduciary duties owed by him in his position as a non-executive director of FS.

The background events to FS's claim occurred in and around July 2004. E had submitted a bid for a contract, which as he knew, was in competition with a bid submitted by FS. E and another director of FS, Mr Ian Brown ("I"), incorporated another company, Balltec Limited ("B") as a vehicle for this business opportunity. Before and after B's incorporation, B bid on two further contracts in competition with FS. B was additionally used to adopt E's original, personal bid.

Of the three competing bids, FS was awarded one contract and B was awarded another. Both were unsuccessful on the third bid. For the contract awarded to it, FS had been forced to lower their bid because of a lower bid submitted by B.

FS brought proceedings in December 2010 (more than six years after the events complained of) claiming damages in respect of these events. FS had reached a settlement on all its claims against I, and I was therefore not a defendant to FS's claim. In respect of E, Norris J held:

1. E must be taken to have known of FS's intended and eventual bids on the same contracts that B submitted bids for and had therefore acted in breach of his fiduciary duties to FS.
2. FS's claim was not statute barred, as it fell within s. 21(1)(a) of the LA 1980 because of the dishonesty of E.
3. It was ordered that E should pay equitable compensation to FS in respect of (a) the lower bid FS was forced to make on the contract it was awarded, and (b) the loss of chance in respect of the two further contracts it was not awarded.

E appealed on the basis that that the claim was statute-barred by reason of s. 21(3) of the LA 1980 because (he argued):

1. S. 21(1) is limited to cases where a trustee had (i) misappropriated property vested in him or under his control and/or (ii) a constructive trust has come into existence, neither arising in this case; and
2. It was not open to Norris J to decide that E's breach of his fiduciary was dishonest, i.e. fraudulent, so that s. 21(1)(a) applied, since an allegation of fraud had not been pleaded or put to him in cross-examination.

Patten LJ, with whom Kitchin and Briggs LJ agreed, dismissed the appeal on both grounds. Patten LJ began his analysis by referring to the relevant statutory provisions, including the definition of 'trustee' under s. 38(1), which adopts the definition given in the [Trustee Act 1925 \("TA 1925"\), s. 68\(17\)](#):

"the expression 'trust' and 'trustee' extend to implied and constructive trusts... and to the duties incident to the office of personal representative, and 'trustee' where the context admits, includes a personal representative..."

Patten LJ considered the distinction between the two types of constructive trust, as set out in [Paragon Finance Plc v DB Thakerar & Co \[1998\] EWCA Civ 1249](#), being:

1. Class 1: Where a defendant receives property under a transaction by which both parties intended to create a trust and the defendant trustee was to hold the property on trust for the claimant beneficiary; and
2. Class 2: Where a defendant, by fraud, receives property without there being a pre-existing trust, but where the defendant is treated as a trustee for the purposes of relief.

A trustee created under a Class 2 constructive trust is not a trustee for the purposes of s. 21(1). Class 2 constructive trustees “are in reality neither trustees nor fiduciaries, but merely wrongdoers”.

A Class 1 constructive trustee really is a trustee, and falls within the definition s. 68(17) of the TA 1925.

The meaning of ‘trustee’ for the application of LA 1980 s. 21 depends upon the status of the defendant at the time the cause of action arose, not when the remedy is determined. Patten LJ noted at [42] that this approach was recently affirmed by the UK Supreme Court in [Williams v Central Bank of Nigeria \[2014\] UKSC 10](#).

Patten LJ noted that a director who misappropriates company property in breach of their fiduciary duties is to be treated as having committed a breach of trust, under a Class 1 constructive trust (applying [JJ Harrison \(Properties\) Ltd v Harrison \[2001\] EWCA Civ 1467](#)).

However, the events giving rise to the claim in *First Subsea* involved a fraudulent breach of trust that did not involve a misappropriation of company property. E relied upon this to submit that LA 1980, s. 21(1) did not apply. E submitted that s. 21(1) has no application to a Class 2 constructive trust (i.e. breaches which do not involve a misappropriation of trustee property) even where the fraudulent breach is committed by a Class 1 constructive trustee (i.e. a company director). E’s argument focused on the cause of action, rather than the status of the person who committed the wrong.

Patten LJ did not accept this analysis and relied upon the Court of Appeal's decision in [Gwembe Valley Development Co Ltd v Koshy \(No 3\) \[2003\] EWCA Civ 1048](#). The approach of the CoA in *Gwembe* was that, when a company director, a Class 1 constructive trustee, commits a breach of their fiduciary duties that does not involve a misappropriation of trustee property, a Class 2 constructive trust will arise for the claimant to obtain equitable relief in respect of the property. However, the Court of Appeal also identified that the finding of a Class 2 constructive trust in this respect does not detract from the defendant's original position as a Class 1 constructive trustee, such trustees falling within the meaning of 'trustee' in s. 21 of the LA 1980. Subsequently, if a claimant can establish that such a breach of a fiduciary duty was fraudulent, s. 21(1)(a) of the LA 1980 will apply.

In a pithy summary of the reasoning underpinning his judgment, Patten LJ said at [62] that:

"[A] director cannot be a class 1 fiduciary for the purposes of [LA 1980] s. 21(3) but not for the purposes of s. 21(1) and for the same reason I do not see how it is possible to treat a director differently as between s. 21(1)(a) and s. 21(1)(b)."

E's further submissions in respect of fraud not being pleaded against E were similarly not accepted by Patten LJ, whom held that Norris J was correct to find, on the papers and the oral evidence, that a case of fraud had been put to, and proved against, E.

Analysis

Company directors fall within the definition of "trustee" under s. 21 of the LA 1980. A fraudulent breach of fiduciary duty by a company director will therefore cause s. 21(3) of the LA 1980 to be disapplied so that no limitation period applies to the claim.

Patten LJ also commented at [50] that LA 1980 s. 21 is the appropriate limitation provision when dealing with company directors' breach of fiduciary duties:

"It seems to me... there is no need to resort to the application of the statutory provisions by analogy under [LA 1980] s. 36(1) when one is dealing with a class 1 fiduciary such as a director... a director is a 'trustee' within the extended definition contained in s. 38(1) and s. 21 is therefore directly applicable to claims which are made against a director for breaches of his fiduciary duties."

As helpful as the clarification in *First Subsea* is, it has left open the question of the application of s.21(1)(b) and whether the order made by the trial judge for an account or equitable compensation was sufficient to bring the claim within the section as a claim to recover trust property. The difficulty with the application of s.21(1)(b) to the facts of the case was that there was no property of FS for which E was liable to account. The use of companies as transferees for property misappropriated by directors will not prevent s.21(1)(b) from applying where the company is directly or indirectly controlled by the wrongdoing director, as was held by the Court of Appeal in *Burnden Holdings (UK) Ltd v Fielding* [2017] 1 W.L.R. 39. This does not however resolve the question of whether the lack of a proprietary claim defeats the application of s.21(1)(b). The trial judge held that it did not apply. This is consistent with the words of s.21(1)(b) which requires that the claim be "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."

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