



Indemnities and Exemption Clauses

by Paul Richardson
Partner

Perpetual Media Capital Limited –v- Enevoldsen and others

The Royal Court of Guernsey has recently handed down a judgment concerning an indemnity and exemption clause provided in a company's articles of association (*Perpetual Media Capital Limited –v- Enevoldsen, Hannah, Howe, Tustin and Marlborough Trust Company Limited* [26 June 2013]).

The judgment considers the following points:

1. The incorporation into a contract between the company and its directors of an indemnity contained in the company's articles of association;
2. Reliance on an indemnity where a claim is made by the company itself;
3. The date on which an indemnity is "provided";
4. The operative date of an indemnity; and
5. The effect of an exemption.

Considering each in turn:

1. The incorporation into a contract between the company and its directors of an indemnity contained in the company's articles of association

The parties and the Court agreed that (as expressed by Ferris J in *John v Price Waterhouse* [2002] 1 WLR 953 at 960) "the articles of a company constitute a contract between the members of the company inter se and between each of them and the company but they do not, without more, constitute a contract between the company and its directors or auditors."

The *Perpetual Media* judgment confirms:

- i) that "the source of a director's exemption or indemnity might be solely from the company's constitutional documents" (paragraph 17);
- ii) that the threshold for the incorporation into the contract between the company and the director of the relevant provision of the articles was a low one (paragraph 18) that was in this case satisfied; and
- iii) the fact that the directors did not seek to raise the question of indemnity or exemption at the earliest opportunity in the proceedings did not without more suggest that the directors were unaware of the provision previously. It had been argued that ignorance of the provision may have precluded its incorporation by implication into the contract between the company and the directors (paragraph 19).

2. Reliance on an indemnity where a claim is made by the company itself

The judgment confirms that an indemnity may be invoked in relation to a claim brought by the company itself (paragraph 24).

3. The date on which an indemnity is "provided"

The date that the exemption or indemnity was "provided" within the meaning of Regulation 10 of the Companies (Transitional Provisions) Regulations, 2008 ("Transitional Provisions") was in the circumstances considered to be the date the exemption or indemnity was provided to any holder of the relevant offices,

rather than to the directors in question. The fact that the directors were appointed after a change in the law had rendered similar future provisions void did not preclude them from relying on the indemnity, as the indemnity was “provided” on the date of the articles.

Section 42(1) of the Companies (Guernsey) Law, 2008 gives a power to a company to alter its Articles of Association. Section 42(2) provides that:

“An alteration so made in respect of a company’s articles shall, subject to the provisions of this Law, have the same effect as if originally contained therein and shall be subject in a like manner to alteration by special resolution.”

Similarly, while it was not argued that the adoption of a new set of articles which restated the same provision in identical words amounted to a fresh provision of the indemnity, it was held in any event that the effect of section 42 is such that the ‘new’ article containing the indemnity “falls to be treated as if it were the article from the outset.” (paragraph 42).

4. The operative date of an indemnity

The validity and enforceability of exemptions or indemnities of the sort provided had been extended by the Transitional Provisions to 31 December 2009. The question before the Court was whether this meant that reliance could not be placed on the provision after that date. The breaches in question occurred prior to 31 December 2009. The issue was therefore stated as follows in the Judgment (paragraph 44):

“If the date under consideration relates to when the breaches alleged occurred, there is no issue. However, if the key date is when those Defendants are entitled to invoke the exemption or indemnity provision, then the Defendants cannot claim to have a complete defence to the Plaintiff’s action.”

It was noted that the general principle set out in paragraph 28-049 of Chitty on Contracts that “the limitation period starts to run when the indemnifying party’s liability is established” but that is “subject to the construction of the contract of indemnity”. On construing the relevant indemnity, it was held that (paragraph 46):

“the effect of that provision is that the indemnity is given to whoever is found to be liable, but in respect of what happened at the time the person was, in this instance, director. Whilst it is obvious that reliance on the indemnity given is not triggered until a liability is established, that liability looks backwards to the time of the actions or omissions in question... Accordingly because the time of the alleged breaches was before 31 December 2009, having found that the indemnity provided to the [directors] was not void, I further find that they can still rely on it now.”

5. The effect of an exemption

It was held that the provision contained an exemption clause in respect of liability that would otherwise attach. The effect of this clause was that the “usual duty of care has been modified; indeed it has been removed.”

As a result “the effect of removing the duty of care can only be properly be regarded as operating at the time of the act or omission about which complaint could be made.” As the potential breaches in question took place in 2009, this was the date on which the removal of the duty of care operated and as a result the directors “have not through the operation of section 157 of the 2008 law lost the opportunity to rely upon the exemption provided to them by the Plaintiff because they claim its benefit after the end of the transitional period prescribed in the 2008 regulations.” (Paragraph 48).

Conclusion

The judgment provides guidance and clarification on issues arising from the changes to the regime governing indemnities and exemption clauses set out in the Companies (Guernsey) Law, 2008, and is understood to represent the first occasion that the Court has considered the interplay between the provisions of that Law and the Transitional Provisions made in respect of its implementation.

As such, and given the novelty of some of the issues it seeks to determine, it may be that the Court has more to say on these issues in future.

In the meantime, it appears that in certain circumstances, indemnities and exclusions that would, if given today, be void, can still prima facie be relied on in respect of breaches taking place prior to 31 December 2009. This is the case notwithstanding Regulation 10 of the Transitional Provisions, which many had thought had closed the door on their use.

For further information please contact:

Advocate Paul Richardson, Partner

Tel: +44 (0)1481 743999

Email: prichardson@afadvocates.com