

# Directors' indemnities

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The Companies (Jersey) Law 1991 (the **Companies Law**) imposes restrictions on the ability of a Jersey company and other persons to indemnify a director of a Jersey company against claims and liabilities arising as a result of the director carrying out the director's duties as a director.

This guide examines the extent to which a director may be indemnified or protected against such claims and liabilities.

## The general prohibition

Subject to the exceptions mentioned below, the Companies Law prohibits a company and its subsidiaries from exempting any director from, or indemnifying any director against, any liability incurred by the director as a result of the director acting as a director of the company. It also prohibits any other person from doing so in exchange for a benefit conferred or detriment suffered, directly or indirectly, by the company.

Any provision, whether contained in the articles of association of, or in a contract with, a company or otherwise which breaches these prohibitions is void.

## Against which liabilities may a director be indemnified?

The Companies Law provides the following exceptions to the general prohibition.

### Defence costs

Any liability incurred in defending any civil or criminal proceedings:

- in which judgment is given in the director's favour or the director is acquitted;
- which are discontinued otherwise than for some benefit conferred by the director (or on the director's behalf) or some detriment suffered by the director; or
- which are settled on terms which include that benefit or detriment and, in the opinion of a majority of the directors (excluding the director(s) who conferred that benefit or on whose behalf that benefit was conferred or who suffered that detriment), the director was substantially successful on the merits in resisting the proceedings.

### Third party liabilities

Any liability incurred to a third person if the director acted in good faith with a view to the best interests of the company.

### Applications for relief

Any liability incurred in connection with an application for relief of liability under the Companies Law in respect of which the court grants relief to the director.

The Companies Law empowers the court to excuse a director, on such terms as it thinks fit, either in whole or part, from any liability for negligence, default, breach of duty or breach of trust where the director has

acted honestly and the court considers that the director ought fairly to be relieved. The court also has power to grant relief in respect of claims brought against a director by a third party affected by the director's breach. In practice, however, the court is only likely to exercise these powers in favour of a director in rare cases.

## Insurance

Any liability in respect of which the company normally maintains insurance for persons other than directors.

### D&O Insurance

In addition to the exceptions to the general prohibition mentioned above, the Companies Law also permits a company to purchase and maintain directors' and officers' liability insurance (**D&O insurance**). D&O insurance will be important from the perspective of both the company and the director because:

- an indemnity from the company may be worthless if the company becomes insolvent;
- the defence costs of a director may be funded by the insurer under the D&O insurance policy; the D&O insurance policy may extend to liabilities for which the company is unable to indemnify the director (eg damages awarded to the company);
- if a claim is made by the company against the director that is covered by the D&O insurance policy, the company may make a claim under the policy rather than seeking recourse to the assets of the director (which may be insufficient to meet the claim in full); and
- claiming under the D&O insurance policy may avoid protracted litigation.

### Indemnities from third parties

An indemnity given to a director by a third party (including a parent company) will be valid provided that the company does not induce the third party to give the indemnity by, directly or indirectly, conferring a benefit on the third party or suffering a detriment on behalf of the third party. Therefore, the company must not, for example, give the third party a counter-indemnity or other payment obligation under which the company will pay or reimburse the third party for any payment made by it under the indemnity.

### Liabilities incurred to the company

Although a company may, in the circumstances mentioned above, indemnify a director in respect of defence costs in proceedings brought by the company, the company cannot indemnify the director against any liability incurred by the director to the company.

### Defence costs

The Companies Law does not permit a company to fund by way of indemnity the defence costs of a director as the costs are incurred. A company may only indemnify a director in respect of defence costs once judgment has been given in favour of the director or the proceedings have been settled or discontinued in circumstances where the company is permitted to indemnify the director by the Companies Law.

A company may, however, lend money to a director to fund the director's defence costs. Frequently, an indemnity will include a provision under which the company agrees to lend the director the amounts necessary to fund the director's defence costs.

It will be a term of the loan that, if the director successfully defends the proceedings or the proceedings have been settled or discontinued in the circumstances where the company is permitted to indemnify the director by the Companies Law, the amount of the loan may be set off against the indemnity. If the director is unsuccessful or the proceedings are settled or discontinued in the circumstances where the company is not permitted to indemnify the director, the director must repay the loan.

Before committing the company to make loans to a director to fund the director's defence costs, the board of directors of the company must be satisfied that:

- doing so is in the best interests of the company; and
- it is likely that the director would be able to repay the amounts lent to the director if the director is required to do so.

The UK Companies Act 2006 permits an English company to pre-fund defence costs under an indemnity if the indemnity is a 'qualifying third party indemnity'. In practical terms, a director of a Jersey company will be in the same position as a director of an English company in relation to the funding of defence costs where the loan arrangements mentioned above are put in place.

### **Where contained?**

The indemnity will normally be contained in the company's articles of association, the director's letter of appointment (in the case of a non executive director) or service agreement (in the case of an executive director) or an indemnity agreement between the director and the company or third party.

A company's articles of association constitute a contract between the company and its members only. A director will only be entitled to rely on, and enforce, an indemnity contained in the company's articles of association if the director can show that the indemnity is an express or implied term of the contract between the director and the company. Therefore, if a director wishes to rely on an indemnity contained in the company's articles of association, the director's letter of appointment or service agreement must state that the director is entitled to be indemnified in accordance with that indemnity.

It is preferable for the indemnity to be contained in the director's letter of appointment or service agreement or an indemnity agreement. This will allow the scope of the indemnity (including the limitations and exclusions), the procedures for making claims under the indemnity and the conduct of proceedings brought against the director to be clearly defined.

### **Why indemnify directors?**

The rationale for the restrictions on directors' indemnities in the Companies Law is that a director owes duties to the company under Jersey customary law and the Companies Law and therefore the director should be accountable for the director's actions and the consequences of any breach of the director's duties.

However, directors (especially directors of companies whose securities are listed on a securities exchange or who carry on business in litigious jurisdictions such as the United States) are increasingly being exposed to the risk of claims being brought against them by third parties (especially class actions). The costs of defending such claims can be considerable, especially where the proceedings are complex and protracted.

In addition, in the absence of a suitable indemnity, potential directors (especially non-executive directors) may consider that the amount of their fees would not justify the risks associated with carrying out their duties as a director of the company. Therefore, the company may be unable to attract directors with the expertise and experience desired by the company unless it agrees to indemnify its directors.

Consequently, in most cases, a company would be justified in indemnifying its directors where:

- the company has a complex business;
- the company has securities listed on a securities exchange;
- the company carries on business in litigious jurisdictions;
- it is common place to do so in the industry in which the company operates, especially where the company operates in an industry that is prone to litigation (eg pharmaceuticals or technology); or
- it is necessary to do so to attract directors with the expertise and experience desired by the company.

### **Contacts**

A full list of contacts specialising in corporate law can be found [here](#).