

# COMPANIES ACT 2006

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## EXPLANATORY NOTES

### COMMENTARY

#### *Chapter 7: Directors' Liabilities*

425. The sections in this Chapter (sections 232 to 239) deal with two matters:
- they restate sections 309A to 309C of the 1985 Act (provisions relating to directors' liability). The only substantive changes to those sections are a new provision permitting companies to indemnify the directors of companies acting as trustees of occupational pension schemes (section 235), the creation of a right for members to request a copy of a qualifying third party indemnity provision (section 238(2)), the removal of criminal liability on the part of the company for failures to comply with the requirements of section 237 (copy of qualifying indemnity provision to be available for inspection), provision for regulations to specify places in addition to the registered office where inspection may take place (section 237(3)) and a requirement for all qualifying indemnity provisions to be retained by a company for at least one year after they have expired (section 237(4));
  - they introduce a substantive reform of the law on ratification of acts giving rise to liability on the part of a director (section 239).

#### *Section 232: Provisions protecting directors from liability*

426. This section prohibits a company from exempting a director from, or indemnifying him against, any liability in connection with any negligence, default, breach of duty or breach of trust by him in relation to the company. *Subsection (2)* prohibits indemnification by an associated company as well as by his own company. "Associated company" is defined in section 256 as, in effect, a company in the same group.
427. Any provision, whether in the company's articles, in a contract or otherwise, attempting to exempt or indemnify a director in breach of this section is void. But this does not apply to lawful provisions in the articles for dealing with conflicts of interest.

#### *Section 233: Provision of insurance*

428. This section permits a company to purchase and maintain insurance for its directors, or the directors of an associated company, against any liability attaching to them in connection with any negligence, default, breach of duty or breach of trust by them in relation to the company of which they are a director.

#### *Section 234: Qualifying third party indemnity provision*

429. This section permits (but does not require) companies to indemnify directors in respect of proceedings brought by third parties (such as class actions in the US). It also permits (but does not require) companies to indemnify directors in respect of applications for relief from liability made under section 1157 (general power of the court to grant relief

in case of honest and reasonable conduct) or under section 661(3) or (4)(power of court to grant relief in case of acquisition of shares by innocent nominee).

430. The indemnity may cover liability incurred by the director to any person other than the company or an associated company. This may include both legal costs and the financial costs of an adverse judgement. But the indemnity must not cover liabilities to the company or to any associated company (*subsection (2)*).
431. Another condition is that the indemnity must not cover criminal fines, penalties imposed by regulatory bodies (such as the Financial Services Authority), the defence costs of criminal proceedings where the director is found guilty, the defence costs of civil proceedings successfully brought against the director by the company or an associated company and the costs of unsuccessful applications by the director for relief (*subsection (3)*).
432. *Subsections (4) and (5)* explain when legal proceedings will be considered to have concluded for the purpose of the conditions imposed by subsection (3).
433. An indemnity that complies with these conditions is described as a qualifying third party indemnity provision.

***Section 235: Qualifying pension scheme indemnity provision***

434. This section permits (but does not require) companies to indemnify a director of a company acting as a trustee of an occupational pension scheme against liability incurred in connection with the company's activities as trustee of the scheme. An indemnity that complies with the conditions set out in this section is described as a qualifying pension scheme indemnity provision.

***Section 236: Qualifying indemnity provision to be disclosed in directors' report***

435. If a qualifying indemnity provision is in force for the benefit of one or more directors or was in force during the previous year, this must be disclosed by the company in the directors' report (as to the directors' report, see Chapter 5 of Part 15). Where the director is of one company but the qualifying indemnity provision is provided by an associated company, then it must be disclosed in the directors' reports of both companies. Companies which choose not to indemnify directors will not have to make any disclosure.

***Section 237: Copy of qualifying indemnity provision to be available for inspection***

436. This section requires a company to keep available for inspection copies of all the qualifying indemnity provisions it has made for its own directors, and also copies of all those it has made for directors of associated companies.
437. *Subsection (4)* is a new provision. It requires all qualifying indemnity provisions to be retained and made available for inspection for a further year after they have expired or terminated. But the company is not required by this section to retain copies of the indemnity provision thereafter.
438. *Subsection (6)* makes a failure to comply with the requirements of this section a criminal offence. The maximum penalty that can be imposed on summary conviction is a fine not exceeding level 3 on the standard scale (currently £1,000) or in cases of continued contravention a daily default fine not exceeding one-tenth of that. In a change from the current position under section 309C of the 1985 Act, the company will no longer be liable under the criminal offence.

**Section 238: Right of member to inspect and request copy**

439. This section gives members a right to inspect without charge the copies of the qualifying indemnity provisions (or where they are not in writing, the written memorandum of their terms) held by the company in accordance with section 237.
440. This section also creates a new right for members on payment of a fee to request a copy of the copy or memorandum held by the company. The fee will be set by regulations made under section 1137.

**Section 239: Ratification of acts of directors**

441. This section preserves the current law on ratification of acts of directors, but with one significant change. Any decision by a company to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company must be taken by the members, and without reliance on the votes in favour by the director or any connected person. Section 252 defines what is meant by a person being connected with a director. For the purposes of this section it may also include fellow directors (*subsection (5)(d)*).
442. If the ratification decision is taken by way of a written resolution (see Chapter 2 of Part 13) the director and his connected persons may not take part in the written resolution procedure (*subsection (3)*). This means that the company does not need to send them a copy of the written resolution, and they are not counted when determining the number of votes required for the written resolution to be passed.
443. If the ratification decision is taken at a meeting, those members whose votes are to be disregarded may still attend the meeting, take part in the meeting and count towards the quorum for the meeting (if their membership gives them the right to do so).
444. *Subsection (6)* makes clear that nothing in this section changes the law on unanimous consent, so the restrictions imposed by this section as to who may vote on a ratification resolution will not apply when every member votes (informally or otherwise) in favour of the resolution. The subsection also makes clear that nothing in this section removes any powers of the directors that they may have to manage the affairs of the company.
445. *Subsection (7)* explains that the requirements imposed by this section are in addition to any other limitations or restrictions imposed by the law as to what may or may not be ratified and when.