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THE COMPANIES ACT 2006 – EXONERATIONS AND INDEMNITIES

1 INTRODUCTION

The Companies Act 2006 (the 2006 Act) aims to codify all existing company law. Although it will not be completely in force until October 2008, some of its provisions have been brought forward and are now coming in from 1 October this year.

For occupational pension schemes with a corporate trustee (Trustee Company) at the helm, this will once again bring about important changes to the protection of its directors from liability. (Confusingly, there will be three different regimes governing such protections from 1 October - see section 3.) Here we look at what is in store and what action may be needed.

2 KEY POINTS

From 1 October 2007

- A provision exempting (or exonerating) directors (Trustee Directors) of a Trustee Company from liability in relation to that Trustee Company will be void (see section 4).
- Subject to certain exceptions, indemnities provided by a Trustee Company (or an associated company) to its Trustee Directors will be void (see section 5).
- But an associated sponsoring employer will be able to indemnify Trustee Directors if certain conditions are met (see section 6).

From 1 October 2008

- New requirements relating to the management of director conflicts of interest are also on the more distant horizon.

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3 THE THREE REGIMES

Much of the current Companies Act 1985 (the 1985 Act) has been transposed into the 2006 Act. Therefore, the 2006 Act does not materially change the existing law when it comes to exempting directors from liability.

Transitional provisions published recently[1] mean that the 2006 Act will only apply to indemnities which are made on or after 1 October 2007. However, certain changes to the 1985 Act were similarly "transitioned in" back in October 2004. The upshot is that, from 1 October 2007, there may be up to three different Companies Act regimes regulating the provision of indemnities by a company in favour of its directors. In summary, these are:

- **Pre-29 October 2004** - this is covered by section 310 of the 1985 Act which only inhibits exemptions and indemnities given by a company to its own directors in relation to the company.

- **From 29 October 2004** - changes made from this date were intended to relax the law but instead resulted in a company being unable to indemnify (directly or indirectly) either one of its own directors or those of an associated company[2] in respect of liability arising in relation to the company.

- **From 1 October 2007** - although indemnities provided in the circumstances highlighted immediately above will still generally be void, representing a real step forward from the current regime, there is a new pensions carve-out being introduced by the 2006 Act (see section 6 below).

[1] The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007 (SI 2007/2194)
[2] Generally a subsidiary, holding company, or a company within the same group

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4 EXEMPTIONS (AND EXONERATIONS)

The 2006 Act[3] renders void any provision purporting to exempt a director of a company from liability "in connection with any negligence, default, breach of duty or breach of trust *in relation to the company*" (our emphasis). So, for example, any exemption from liability of its Trustee Directors set out in a Trustee Company's articles of association will fall foul of this prohibition.

Exemption clauses commonly found in pension scheme rules are primarily designed to protect the Trustee Company (and its Trustee Directors) from potential claims by members and third parties. Therefore, they cannot really be said to be protecting against liability "*in relation to the company*".

5 INDEMNITIES

To recap, the starting point under the 2006 Act[4] is that indemnities provided (*directly or indirectly*) by a company (or a company associated with it) for the benefit of a director are void. This attaches to any liability "in connection with any negligence, default, breach of duty or breach of trust *in relation to the company of which he is a director*" (our emphasis). So what does this mean in practice for occupational pension schemes with corporate trustees?

What's caught?

The following are squarely within the 2006 Act's scope:

- a Trustee Company providing an indemnity to Trustee Directors in relation to that Trustee Company (for example, in the articles of association); and
- a company which is associated with the Trustee Company (such as the scheme principal employer) indemnifying Trustee Directors in relation to that Trustee Company;

[3] Section 232(1)
[4] Section 232(2)

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- indemnities set out in scheme rules if provided by either of the above.

What's not?

- Individual trustees can still benefit from an indemnity given by a sponsoring employer even if they also happen to be a director of that company (or of an associated company).
- Indemnities for Trustee Directors given by companies which are not associated with the Trustee Company[5].

The grey area

Indemnities payable out of scheme assets where the sponsoring employers are associated with the Trustee Company may arguably come within the 2006 Act (and its 2004 predecessor). This is because both regimes prevent indemnities being given *directly or indirectly.* In a typical balance of cost scheme (such as defined benefit), the sponsoring employers are responsible for making good any deficit and will ultimately (*indirectly*) foot the bill for any indemnity liability.

6 WAYS OUT UNDER THE 2006 ACT

As now, a company will be able to take out indemnity insurance to protect its directors. In addition, a company can shield its directors against liability incurred in relation to third parties if particular requirements are met.

More significantly, the 2006 Act will introduce a specific carve-out, a "qualifying pension scheme indemnity provision" (QPSIP), for Trustee Directors. Under a QPSIP, a Trustee Company (or an associated company) can indemnify its Trustee Directors "against liability incurred in connection with the company's activities as trustee of the scheme". That indemnity must not, though, extend to any liability:

[5] For example, a Trustee Company whose shares are wholly owned by the Trustee Directors will not be "associated" with other companies

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- to pay criminal fines or regulatory penalties; or
- incurred in defending criminal proceedings in which the Trustee Director is convicted.

7 WHAT ACTION IS REQUIRED?

Amending an existing indemnity on or after 1 October 2007 is likely to bring it within the 2006 Act's remit. Also, a Trustee Director appointed after that date is likely to come within its control (although in some cases this may be less clear-cut). However, it is unclear whether merely restating a pre-existing indemnity (in an updated set of scheme rules) will have a similar result.

Trustee Companies will no doubt be concerned that Trustee Directors appointed on or after 1 October 2007 benefit from any sponsoring employer indemnity (and, to the extent necessary, that this is QPSIP compliant). They will therefore wish to raise this with sponsoring employers as changes to scheme documents may be necessary. In doing so, it will be important to keep existing Trustee Director protections intact unless, of course, the 2006 Act provisions are more favourable.

With the potential to have a three-tier indemnity from 1 October 2007 (under the three Companies Act regimes), some Trustee Companies may wish to streamline indemnities across the board so that they all meet the terms of a QPSIP. But as there are other possible options open to Trustee Companies (although some less feasible than others), they should consider their 2006 Act actions as soon as possible with their advisers.

Nothing stated in this document should be treated as an authoritative statement of the law on any particular aspect or in any specific case. Action should not be taken on the basis of this document alone. For specific advice on any particular aspect you should consult the usual solicitor with whom you deal. **© Sacker & Partners LLP August 2007**

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