



PROTECTING DIRECTORS AND OFFICERS OF BERMUDA COMPANIES: A matter of good corporate governance.

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It is not easy being a director or an officer of a company these days. Enhanced standards of corporate governance, such as the Sarbanes-Oxley legislation in the United States, as well as increased shareholder litigation and regulatory scrutiny, can expose company directors and officers to significant financial and legal risk.

As one of the world's premier off-shore jurisdictions, Bermuda is the domicile of choice for international companies operating in many different countries. Many of the "exempt" companies incorporated in Bermuda (i.e. companies which do not conduct local business), appoint non-Bermudian directors and officers to the board of directors, or to management positions within the Bermuda company. Persons accepting board or management appointments with a Bermuda company should be aware of the legal protections which are available to them under Bermuda law.

The Companies Act, 1981

Most exempt companies operating in Bermuda are incorporated under The Companies Act, 1981 (the "Act"). Section 98(1) of the Act provides that a company:

"...may in its bye-laws or in any contract or arrangement between the company and any officer,... exempt such officer..., or indemnify him in respect of, any loss arising or liability attaching to him by virtue of any rule of law in respect of any negligence, default, breach of duty or breach of trust of which the officer ... may be guilty in relation to the company or any subsidiary thereof."

The first thing to note about S. 98 is that it is discretionary – that is, the company "may" exempt or indemnify an officer, but it is not mandatory. So officers (which under the Act, includes directors) who are considering taking up an appointment with a Bermuda exempt company must confirm that the company's bye-laws contain the appropriate indemnity. Fortunately, most standard form company bye-laws utilized in Bermuda today contain an indemnity of this nature. Directors should also ensure that it is clear (preferably in writing) that they are taking up their appointment on the basis of the indemnity provisions contained in the bye-laws.

Since bye-laws can be changed without a director's consent, it is often recommended that directors obtain an actual contract of indemnity from their

company rather than relying on the bye-laws. A contractual indemnity from an overseas parent company may also be appropriate where the Bermuda company has no material assets.

An Important Exception

An important exemption to the general rule is contained in Section 98(2) of the Act, which essentially prohibits a company from indemnifying a director or officer in respect of any “fraud or dishonesty” in relation to the company. This is a particularly important provision for the protection of shareholders, who might generally be averse to using the company’s money to defend a director who has defrauded the company. Section 98(2) does however permit a company to pay for the defense of a director accused of fraud or dishonesty in any proceedings, so long as the director is exonerated in the ultimate result.

Interim Payments

Modern commercial litigation can be exceedingly complex and expensive. Directors and officers being sued in their individual capacities for actions taken on behalf of their companies can begin to face crippling legal bills very early in the legal process. For this reason, directors of Bermuda companies will wish to ensure that the company bye-laws, or their contractual indemnity, contain provision for interim payment of indemnity claims. The Act requires that any interim payments must be repaid if allegations of fraud or dishonesty against a director are proved.

D&O Insurance Section 98A of the Act permits a Bermuda company to purchase and maintain insurance for the purposes of responding to indemnification claims from its directors and officers. Directors may wish to ensure that adequate D&O cover is in place in order to be certain that their indemnity claims against the company will be paid. This can be particularly important where the company is facing financial challenges or may be headed for insolvency. If the directors will be relying on D&O insurance to meet indemnity claims, it will be important for the directors to review the terms of the policy to understand the coverage limits, and to respect the terms of the policy, such as prompt notification of potential claims.

Conclusion

Providing proper legal and financial protection for directors and officers who undertake their responsibilities honestly and in good faith with a view to the best interests of the company should be an essential element of modern corporate governance practices. Bermuda corporate law supports these principles, and reinforces Bermuda’s position as one of the leading off-shore jurisdictions in the world today.

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