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*Privy Council Appeal No. 54 of 1984*

**The Viscount** *Appellant*

*v.*

**Barry Shelton and Another** *Respondents*

FROM

# THE COURT OF APPEAL OF JERSEY

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## JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 1ST MAY 1986

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*Present at the Hearing:*

LORD BRIDGE OF HARWICH
LORD BRANDON OF OAKBROOK
LORD BRIGHTMAN
LORD ACKNER.
LORD GOFF OF CHIEVELEY

*[Delivered by **Lord Brightman**]*

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The principal question in this appeal from the Court of Appeal of Jersey, is whether a director can rely on an indemnity clause in the Company's Articles of Association in order to escape personal liability for a loss suffered by the company as a result of his causing the company to do an act alleged to have been *ultra vires* the company. The question comes before the Board as a preliminary issue in an action on behalf of the company against its directors. In essence, the issue is whether the facts alleged in paragraphs 1 to 14 of the plaintiff's pleading are capable of founding a claim for relief in the light of such indemnity clause.

The company, Jomen Limited, was incorporated in Jersey in 1972. The objects clause of the Memorandum is divided into 47 sub-clauses. Sub-clauses (1) to (14) relate to various aspects of the clothing industry. Sub-paragraph (45) provides that "The main objects set forth in the preceeding sub-clauses (1) to (14) inclusive of this clause shall only be carried on in the Channel Islands ...".

On 27th July 1981 the company entered into a contract to buy a property at Longton, Stoke-on-Trent at a price of £165,000.00. A deposit of £16,500,00 was paid. The date fixed for completion was 26th October 1981, but the company began trading from the property in August. The company found itself unable to complete the purchase on the due day. The date for completion was extended to 30th June 1982 on the terms that the company should make monthly payments of £5,000 to the vendors. In the outcome the company ceased trading on 7th May 1972 after only two payments had been made. A week later the goods of the company were declared "en désastre" by Act of the Royal Court of Jersey.

The total disbursements made by the company, namely the deposit, the two payments of £5,000, and a payment of interest made in January 1982, amounted to about £32,000.00. This loss was increased to about £91,000.00 after taking into account trading losses. In addition the vendors are claiming about £29,000.00 damages for breach of contract.

On 8th July 1982 proceedings were begun in the Jersey Court by the Viscount against the directors to recover on behalf of the company the £91,000.00 on the ground that the expenditure was *ultra vires* the company, and also the £29,000.00 damages if this sum should become an admitted claim in the désastre. There were originally four defendant directors but this appeal is concerned only with the liability of two of them, the first and second defendants.

It is necessary to consider the pleadings in a little detail in order to understand how the case has proceeded and what is the true nature of the preliminary issue. Paragraph 14 of the Viscount's amended "Order of Justice" reads as follows:-

> "... the Defendants, as Directors of the Company, are jointly and severally liable for all losses occasioned [to] the Company in the exercise of its purported purchase of real property and the said pursuance of trading activity outside of the Channel Islands, being acts which were *ultra vires* the objects and powers contained in the Memorandum of the Company. ..."

Paragraph 15 reads:-

> "... in the alternative ... the Defendants, as Directors of the Company, are personally jointly and severally liable for the losses occasioned [to] the Company between 1 December 1981 and 7 May 1982 in that they knowingly permitted the Company to continue to trade from the premises 101/103 The Strand, Longton, in the knowledge that the Company was then insolvent and incapable of paying its debts in full on demand."

To put the matter shortly, paragraph 14 charges the defendant directors with liability for loss arising from the alleged *ultra vires* purchase of property at Stoke-on-Trent and the alleged *ultra vires* trading outside the Channel Islands between August 1981 and May 1982, while paragraph 15 charges the defendants with liability for losses occasioned by permitting the company to engage in fraudulent trading between December 1981 and May 1982. It is important to maintain this distinction. The subsequent proceedings before the Deputy Bailiff and the Court of Appeal of Jersey have been concerned only with the liability for losses arising from the alleged *ultra vires* purchase and trading, and not for the losses occasioned by alleged fraudulent trading.

In their amended Answer, the first three defendant directors denied that the company had acted *ultra vires*. If however, it were held that the company had exceeded its powers, the directors relied on clause 46 of the Articles of Association of the company. This clause is a somewhat confusing jumble of verbiage, and for ease of understanding their Lordships will separate it into its component parts:-

"(1) Every Director, officer or servant of the Company shall be indemnified out of its funds against all costs, charges, expenses, losses and liabilities incurred by him

(a) in the conduct of the Company's business, or

(b) in the discharge of his duties; and

(2) no Director or Officer of the Company shall be liable

(a) for the acts, defaults or omissions of any other Director or Officer, or

(b) by reason of his having joined in any receipt for money not received by him personally, or

(c) for any loss on account of defect of title to any property acquired by the Company, or

(d) on account of the insufficiency of any security in or upon which any moneys of the Company shall be invested, or

(e) for any loss incurred through any Bank, broker or other agent, or

(f) for any loss occasioned by any error of judgment or oversight on his part, or

(g) for any loss, damage, or misfortune whatever which shall happen in the execution of the duties of his office or

> in relation thereto, unless the same shall happen through his own dishonesty."

In July 1983 the action came before the Deputy Bailiff on two preliminary issues. The first issue was whether the purchase of the property was *ultra vires* the company. The second issue was whether the plaintiff could "recover the loss incurred by the Company, while trading from the property, from those persons who were the Company's Directors at the relevant time", in other words *ultra vires* trading as distinct from fraudulent trading. The Deputy Bailiff held that the purchase was *ultra vires*, and "directed that evidence should be heard as to whether the directors are entitled to invoke the protection of Article 46 ...". That direction came about in this way. The Deputy Bailiff recorded in his judgment that "any allegations of fraud have now been withdrawn", but he added that "in some cases ... negligence may indicate dishonesty". He took the view that Article 46 was capable of protecting a director from liability for a loss suffered by the company notwithstanding that the loss arose from an *ultra vires* act or activity of the company; and although there was no allegation of fraud in relation to the company's *ultra vires* activities, negligence might amount to "dishonesty" within the meaning of Article 46; therefore evidence of the conduct of the directors was relevant.

The first and second defendants appealed. The gist of their appeal was, first, that the defendants were protected by Article 46: "The only behaviour of the appellants that can be relevant to the operation of the said Article 46 is that of dishonesty and ... any issues of dishonesty have been expressly withdrawn from the consideration of the court from the outset of the hearing ... The Royal Court was wrong in law in stating that negligence may indicate dishonesty"; see paragraphs 21 and 22 of the Defendants' Case in the Court of Appeal. Secondly, it was asserted that the company had not acted *ultra vires*.

Consistently with the case as it had been conducted, the Court of Appeal of Jersey approached the first issue on the basis that "there is no allegation of dishonesty on the part of the directors in relation to the alleged *ultra vires* trading. I say in relation to the alleged *ultra vires* trading because an application to amend the pleadings by alleging fraudulent trading has been granted by the Deputy Bailiff conditionally upon the plaintiff considering it necessary to proceed with such a case after the decision of the preliminary issues to which I have referred and nothing that we say in this judgment affects the right of the plaintiff, should he be so advised, to proceed with the claim for

fraudulent trading". On that basis the court did not find it necessary to decide the question of *ultra vires* because, even if the company had acted *ultra vires*, the court considered that Article 46 afforded protection in the admitted absence of dishonesty. The conclusion reached by the Court of Appeal is summarised in the following passage from the judgment:-

> "Now in this case, what is alleged against these directors is that they were in breach of their duties. The breach of their duties is alleged to have arisen from their improperly procuring the company to enter into a contract which was ultra vires ... the company and for their improperly procuring the company to expend [its] money on ultra vires purposes ... In the context of this article and having regard to its purpose, those were all acts which were done in the execution of the duties of their office. It is true that on the assumption that we have made, those acts were acts in breach of duty but that is the very purpose for the existence of the article. If the acts had not been in breach of duty there would have been no need for any protection of the directors. Consequently, we think that in the absence of an allegation of dishonesty, the matters alleged in paragraphs 1 to 14 of the Order of Justice do not give rise to a cause of action against the directors ..."

For the purposes of the preliminary issue, therefore, the Court of Appeal proceeded on the basis that all the facts alleged in paragraphs 1 to 14 of the amended Order of Justice were true and held that those facts did not give rise to a cause of action in the light of the indemnity clause. Paragraph 15, which is concerned only with fraudulent trading, was unaffected by the decision.

The Viscount appeals from that decision on two grounds. First, it is said that Article 46 does not on its true construction exonerate the respondents from liability for their participation in acts *ultra vires* the company. Secondly, it is said that the Article is void and of no effect if and so far as it purports to confer such exoneration.

On the first proposition, the appellant's argument is that the only exoneration afforded to a director in the context of this case is in relation to a loss, damage or misfortune which shall happen to the company "in the execution of the duties of his office or in relation thereto"; that a director who causes the company to do an act *ultra vires* the company is not acting "in the execution of the duties of his office" but the reverse; therefore he is not exonerated. In support of this argument, the

appellant's counsel relied on a dictum of the English Court of Appeal in *Cullerne v. The London and Suburban General Permanent Building Society* (1890) 25 Q.B.D. 485, also reported in 63 L.T.N.S. 511. In that case the appellant director of a building society had participated in a board resolution which purported to confer on the board authority to make advances to members on the security of their shares. Subsequent resolutions were passed by the board sanctioning particular advances on such security. Losses were made, which the society sought to compel the director to recoup. The Court of Appeal (Lord Esher MR., Lindley and Lopes LJJ.) held that such advances were *ultra vires* the building society. The appellant denied liability first on the ground that he had participated only in the board resolution which purported to confer the power, and not in any of the resolutions to make advances, and secondly on the ground that he was exonerated from liability by Rule 29 of the Society's Rules. This rule, which appears only in the Law Times report of the case, bears a close resemblance to Article 46 in the present case, and the relevant part of Rule 29 is not very different from paragraph (2)(g) of Article 46. It provided that a director should not be answerable:-

> "... for any misfortune, loss, or damage which may happen in the execution of the powers, authorities, and discretion hereby given or herein contained, or in relation thereunto, except the same shall happen by or through their own wilful default respectively."

The court held that as under the relevant statutes a building society could only advance money on landed property, a director participating in the advance of money on other security could not rely on board resolutions as a defence to an action by the society for the restitution of the money wrongfully advanced. The court added:-

> "Nor does Rule 29, relating to the indemnity of the directors, extend to acts which are *ultra vires*, and beyond the powers which the society itself could confer upon them."

This observation was *obiter*, because the decision of the court was that the director in question had participated only in the resolution authorising the invalid type of advance and not in any of the resolutions under which particular advances had been made, and therefore no personal liability attached to him. The dictum does however deserve the respect which their Lordships would naturally be disposed to give to a pronouncement made in a considered judgment of so eminently constituted a court. It is not perhaps perfectly clear whether the court considered that Rule 29 failed as a matter of construction to

cover an act *ultra vires* the company, or considered that the rule however construed was not capable as a matter of law of covering such an act. The two conceptions are closely related. A court of construction, where given the choice, will naturally be disposed to place a narrow construction on such a provision if a wide construction would involve invalidity; it is therefore somewhat unrealistic to approach the question of how a rule of this sort should be construed without first forming a view of the permissible limits of such a rule.

In the opinion of their Lordships Article 46 is worded in a manner which is apt to exonerate a director who has innocently participated in an act which is *ultra vires* the company, and to excuse him from the obligation which would otherwise have lain upon him to reimburse the company for any loss thereby occasioned. Under Article 38 the duty of the directors of the company was to manage its business. The purchase of the property at Stoke-on-Trent, and the trading from that locality, happened in the course of or in relation to the performance by the directors of that duty. The directors, as a matter of construction of the Article, are therefore not liable for the loss which happened to the company. The same answer may also be reached under paragraph (1)(a) of Article 46. The directors are *prima facie* liable to the company for the loss. But that liability was incurred "in the conduct of the company's business". The directors are therefore entitled to be indemnified against such liability. A company has no cause of action against a director in respect of a matter against which the company has agreed to indemnify him.

This result, as a matter of construction, is what one would expect. It is not contested that an article of this sort will exonerate a director against liability for a loss caused to the company by the negligent act of the director. This was decided by Neville J. in *In Re Brazilian Rubber Plantations and Estates Limited* (1911) 1 Ch. 425, which was followed by Romer J. at first instance in *In Re City Equitable Fire Insurance Company Limited* (1925) Ch. 407. The point was kept open for argument in the Court of Appeal in the latter case, but in the event was not challenged. It would be extremely odd if the Articles of a company were intended to give total absolution to a director who had caused loss to the company as a result of his abysmal negligence, but were intended to leave him responsible to the company in a case where, for example, he had sought legal advice whether a contemplated transaction was *intra vires* the company, had been advised by leading counsel that it was *intra vires*, and the director had then acted in accordance with such advice. It would require clear wording to persuade their Lordships

that so unreasonable a result was intended. The plain purpose of Article 46 was to give blanket exoneration to a director for any mistake that he has made which is not tainted by dishonesty.

Their Lordships turn to the second question, whether it is legally possible to have an effective provision in the Articles of a company which exonerates a director from liability for participation in an act which is *ultra vires* the company. The argument for the appellant is as follows. It is not competent for the Articles of Association of a company to modify or exclude the duty of the directors to apply the assets of the company exclusively towards the furtherance of the objects prescribed by the Memorandum of Association. The Articles of Association cannot widen the objects clause. The Memorandum is paramount; *Guinness v. Land Corporation of Ireland* (1882) 22 Ch.D. 349. The Articles cannot modify or exclude that duty so as to enable the assets of the company to be applied for other purposes. If a company is precluded by the Articles from recovering from its directors a loss caused by an *ultra vires* application of its assets, the Articles would in the result enable the company's assets to be applied for *ultra vires* purposes.

Their Lordships do not accept this approach. An article which exonerates a director from personal liability for a loss incurred by the company by reason of an *ultra vires* act in which the director has participated, does not have the indirect effect of validating the act which caused the loss. The act remains *ultra vires* notwithstanding that the company is precluded from suing the director. The clause does not ratify the *ultra vires* act, but only restricts the persons who can be sued for the loss which the *ultra vires* act has caused.

In *Re Claridge's Patent Asphalte Company Limited* [1921] 1 Ch. 543 a somewhat similar point arose on section 279 of the Companies (Consolidation) Act 1908, which enabled the court to relieve an honest director from liability for negligence or breach of trust. It was sought to argue that the section did not apply to a transaction which was *ultra vires* the company. Astbury J., in rejecting this submission, said that all applications of a company's money *ultra vires* the company were breaches of trust on the part of the directors, and there was no reason for limiting the wide generality of the section to breaches of trust where no question of *ultra vires* came in. That was a very different set of facts in that the power to exonerate was conferred by statute. The interest of the case is that the judge saw no reason to draw a distinction between a loss stemming from an act *ultra vires* the company and a blameworthy loss stemming from an act *intra vires* the

company. Nor do their Lordships. In so far as the English Court of Appeal in the *Cullerne* case pronounced otherwise, their Lordships respectfully differ.

This case has been argued throughout on the basis that the law of Jersey is in all relevant respects the same as the law of England, save that English legislation which now invalidates such a clause as Article 46 does not exist in Jersey. However the appellant's counsel sought to argue before the Board that there were some important considerations peculiar to Jersey law which were relevant to the application of Article 46. These considerations had not been the subject matter of any submissions to the Deputy Bailiff or the Court of Appeal of Jersey, and their Lordships declined to allow them to be raised for the first time on the hearing of this appeal. Their Lordships do not know the nature of these special considerations, but if a question similar to that raised in this appeal should come before the Jersey Court in another case, there is nothing in the opinion now given by their Lordships which would preclude reliance on any matter peculiar to the law of Jersey.

In the result their Lordships agree with the conclusion of the Court of Appeal of Jersey that the matters alleged in paragraphs 1 to 14 of the amended Order of Justice, read with Article 46, do not give rise to a right to relief against the respondents. Their Lordships will humbly advise Her Majesty that this appeal should be dismissed. The appellant will pay the costs of the respondents, without prejudice to such right as the appellant may have under the law of Jersey to recover such costs from the assets of the company.