In The Supreme Court of Bermuda

CIVIL JURISDICTION

2014: No. 208

BETWEEN:-

DAVE GERARD PEIRIS

Plaintiff

-and-

(1) RUDOLPH ALEXANDER DANIELS
(2) MARSHALL MINORS
(3) MICHAEL MINORS

Defendants

JUDGMENT
(In Court)

Date of hearing: 11th February 2015
Date of judgment: 4th March 2015

Mr Jai Pachai, Wakefield Quin Limited, for the Plaintiff
Mr Marc Daniels, Charter Chambers Bermuda Limited, for the Defendants

Introduction

1. The Plaintiff is a judgment creditor of Bermuda Building Services Company Ltd ("the Company"). The Defendants were at all material times its

directors. The Plaintiff alleges that the Defendants have been guilty of misfeasance or breach of trust in relation to the Company. He seeks an order pursuant to section 247(1) of the Companies Act 1981 ("the 1981 Act") that they pay the amount of the judgment debt to the Company by way of compensation for their alleged wrongdoing. This is what is known as a misfeasance application.

2. Mr Pachai appeared for the Plaintiff and Mr Daniels for the Defendants. I am grateful to both counsel for their industry and assistance.

Background

3. The Plaintiff was formerly employed by the Company as an air-conditioning mechanic. On 14th August 2008, during the course of his employment, he suffered an industrial accident in which his right arm was severely injured, resulting in permanent partial incapacity. He brought an action against the Company in the Supreme Court under the Workmen's Compensation Act 1965 ("the 1965 Act"). The Court found in his favour, and awarded him $114,365.00 plus interest at the statutory rate and costs. The judgment is reported as Peiris v Bermuda Building Services Company Ltd [2012] SC (Bda) 49 Civ (17th September 2012). The sum awarded for costs on taxation was $54,640.00.

4. The Plaintiff should have had no difficulty in recovering the judgment debt. This is because the Company had a statutory duty to have insurance in place with respect to any liability which it might incur under the 1965 Act ("workers' insurance"). The source of the statutory duty was section 1 of the Workmen's Compensation (Compulsory Insurance) Order 1965 ("the 1965 Order") read in conjunction with the Schedule to the 1965 Order.

5. However the Company did not have workers' insurance in place at the date of the Plaintiff's injury. The First Defendant explained in an affidavit that this was because the Company was in between insurance providers, having decided to switch from its previous insurer to one offering a more favourable rate. He explained that the period for which the Company did not have

workers' insurance in place was no more than a matter of weeks, or possibly a month.

6. The Company should of course have made sure that workers' insurance cover remained in place under the old policy until the new policy came into force. I am satisfied that its failure to do so was most likely due to inadvertence rather than the result of a deliberate decision. It was nonetheless a serious breach of the Company's statutory duty.

7. The upshot is that the Company has not paid the Plaintiff as much as a cent under the judgment. On 31st May 2013 the Company issued a petition to voluntarily wind itself up and on 30th July 2013 the Court made a winding up order on the petition.

8. The First Defendant gave affidavit evidence that the judgment debt had contributed to an already bleak financial outlook for the Company. However, he stated that the most important factors behind the decision to wind up the Company were the expiration of a contract to supply services to the West End Development Corporation, which had been a major source of income for the Company but which the Corporation decided not to renew, and the lack of new business.

Scope of section 247(1)

9. Section 247(1) of the 1981 Act provides:

"*If in the course of winding up a company it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager or liquidator, or any officer of the company, has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application of the Official Receiver, or of the liquidator, or of any creditor or contributor, examine the conduct of the promoter, director, manager, liquidator or officer, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust as the Court thinks just.*"

10. For ease of reference, I shall set out section 247(1) again, but including only the material parts:

> "*If in the course of winding up a company it appears that … any past or present director … has … been guilty of any misfeasance or breach of trust in relation to the company, the Court may, on the application … of any creditor … examine the conduct of the … director … and compel him … to contribute such sum to the assets of the company by way of compensation in respect of the … misfeasance or breach of trust as the Court thinks just.*"

11. Section 247(1) does not create any new rights or liabilities, but is rather a summary procedure by which existing causes of action accruing to a company can be enforced. Thus in Coventry and Dixon's Case (1880) 14 Ch D 660 EWCA, James LJ, with whom Baggallay LJ agreed, stated of the substantially similar wording of section 165 of the Companies Act 1862 ("the 1882 Act"):

> "*I am of opinion that that section does not create any new liability or any new right, but only provides a summary mode of enforcing rights which must otherwise have been enforced by the ordinary procedure of the Courts. In order to enable the Court to apply that section, the liquidator, as it seems to me, must shew something which would have been the ground of an action by the company if it had not been wound up. I am of opinion also that the word "misfeasance" in that section means misfeasance in the nature of a breach of trust, that is to say, it refers to something which the officer of such company has done wrongly by misapplying or retaining in his own hands any moneys of the company, or by which the company's property has been wasted, or the company's credit improperly pledged. It must be some act resulting in some actual loss to the company.*"

12. The nature of the cause of action necessary to give rise to a claim in misfeasance has been considered in a number of further cases. The Defendants place particular reliance on In re Wedgwood Coal and Iron Co (1882) 47 LT 612, in which Fry J (as he then was) said of section 165 of the 1882 Act:

> "*There is, however, a difference which the law recognises, between 'misfeasance' and 'non-feasance'; in other words, between sins of commission and sins of omission, and I think therefore that the Legislature plainly did not refer to cases of mere non-feasance except, of course, where there has in fact been a breach of trust. There was no intention of giving this power of summary proceedings in such a case. In my view, that is the plain*

construction of the Act."

13. These observations were approved by Maugham J (as he then was) in In re Etic [1928] 1 Ch 861 Ch D at 872 – 873: He stated:

"*I believe that the language of Fry J. (as he then was) in making a sort of distinction between misfeasance and non-feasance has been criticized, but I do not find that the substance of his judgment has been adversely criticized at all; in other words, I think that the decision is that the section applies only to cases where there has been in some true sense a misapplication or retention of moneys or property of the company or a positive misfeasance or breach of trust. I am satisfied that on the true construction of the section and upon the authorities, if, for instance, a director of a company happened to carry on, we will say, a business of some kind and became indebted to the company for a breach of contract entered into by him not as a director at all but in his capacity of an independent person, no summary proceeding under s. 215 would be in the least applicable to such a case. The company, as in nearly every case in an ordinary simple contract debt, or an ordinary claim of the company for unliquidated damages, would be left to bring the action in the ordinary way, in which action the defendant officer would be entitled to any set-off or counterclaim which was open to him, and would be entitled to security for costs to be given by the company.*"

14. Thus what Maugham J meant by "*a positive misfeasance or breach of trust*" was a breach of duty to the company committed by a director or other officer acting in his capacity as such. The learned judge made this pellucidly clear at page 875, when he said of section 215 of the Companies (Consolidation) Act 1908, which was the successor to section 165 of the 1882 Act:

"*The conclusion at which I have arrived is that s. 215 is not applicable to all cases in which the company has a right of action against an officer of the company. It is limited to cases where there has been something in the nature of a breach of duty by an officer of the company as such which has caused pecuniary loss to the company.*"

15. I respectfully concur. The material distinction is not between an act and an omission, but rather between an act committed by a director or other officer in his capacity as such and an act committed by him in some other capacity.

16. An application under section 247(1) cannot be brought until after the winding up has commenced. But it can be brought with respect to events which took place before the winding up commenced. To hold otherwise, as

the Defendants have invited me to do, would make no sense from a legislative point of view; run contrary to the natural and ordinary meaning of the statutory language; and go against the decided cases: eg in both Coventry and Dixon's Case and In re City Equitable Fire Assurance Co Ltd [1925] 1 Ch 407 EWCA ("City Equitable"), which I shall consider in more detail below, the judgments were predicated on the assumption that under the analogous English legislation an application would lie with respect to acts committed before the winding up commenced.

17. The applicant must, however, show that he is interested in the result of the application. As Lord Macnaghten stated in Cavendish Bentinck v Fenn (1887) 12 App Cas 652 HL at 669:

> "*Apparently it has not been judicially determined that the applicant is bound to shew that he is interested in the result of the application, but I think it must be so. I cannot think that Parliament intended that a person who happens to come under the description of a creditor or a contributory may take upon himself the functions of a public prosecutor in a matter with which he has really no concern.*"

Misfeasance

18. The Plaintiff alleges that the Defendants' failure to ensure continuity of workers' insurance cover during the changeover from one insurer to another was a breach of the duty of care and skill which as directors they owed to the Company. Put another way, the Defendants in breach of that duty permitted the Company to employ the Plaintiff without having workers' insurance cover in place. The consequential loss to the Company is the amount of the judgment debt.

19. The Plaintiff is clearly interested in the result of the application. He is a preferred creditor of the Company under section 236(1)(e) of the 1981 Act as the Company is liable to pay him compensation under the 1965 Act. Consequently, he stands to benefit from any monies that pursuant to the application the Defendants are ordered to pay to the Company.

20. As to breach of duty, section 97(1) of the 1981 Act provides:

"*Every officer of a company in exercising his powers and discharging his duties shall—*

. . . . .

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

21. The 1981 Act does not provide in express terms that a breach of section 97(1) will give rise to a cause of action. But this is implicit in section 98A, which provides:

"*A company may purchase and maintain insurance for the benefit of any officer of the company against any liability incurred by him under section 97(1)(b) in his capacity as an officer of the company or indemnifying such an officer 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 and nothing in this Act shall make void or voidable any such policy.*"

22. If a breach of section 97(1) does not give rise to a cause of action, then it would not be possible for an officer of the company to incur any liability under it. But section 98A expressly acknowledges that it is possible for an officer to incur liability under the section.

23. Section 97(1) of the 1981 Act gives statutory force to a common law duty. Thus in Dorchester Finance Co Ltd v Stebbing [1989] BCLC 498 Ch D at 501 – 502, Foster J accepted as an accurate statement of the law that:

"*A director is required to exhibit in performance of his duties such a degree of skill as may reasonably be expected from a person with his knowledge and experience.*"

24. The duty is not fiduciary in character as it is concerned with competence rather than honesty and loyalty. See Ultraframe v Fielding [2005] EWHC 1638 (Ch) *per* Lewison J at paras 1300 – 1302.

25. The existence of the duty was not controversial. In considering its application to the facts of this case, I bear in mind the observation of Lord Woolf MR in Re Westmid Packing Services Ltd [1998] 2 BCLC 646 EWCA at 653 that:

"*Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them.*"

26. A director's duty to act with reasonable care, diligence and skill may be breached through omission. Eg City Equitable and many other reported directors' indemnity cases were concerned with indemnities which excluded "*wilful neglect or default*" by the directors. The issue in such cases was typically whether the conduct in relation to which the directors sought indemnification amounted to "*wilful neglect or default*". Such conduct might comprise acts or omissions. See, eg, the judgments in City Equitable of Pollock MR at 517; Warrington LJ at 523; and Sargant LJ at 529, who cited with approval the following passage from the judgment at first instance of Romer J:

"*But if that act or omission amounts to a breach of his duty, and therefore to negligence, is the person guilty of wilful negligence? In my opinion that question must be answered in the negative unless he knows that he is committing and intends to commit a breach of his duty, or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty.*"

27. The hearing before the Court of Appeal was concerned with alleged breaches of duty by the company's auditors. At first instance, however, Romer J had also been concerned with alleged breaches of duty by the directors. He found at page 468 that two of the directors were guilty of a breach of their duty to the company in failing to safeguard and control the monies of the company that were not in a state of permanent investment. In other words they were guilty of a negligent omission. But the learned judge found that their negligence was not wilful, and that by reason of the indemnity in the company's bye-laws they were therefore absolved from liability.

28. City Equitable appears not to have been followed in the first instance decision of the Irish High Court in Jackson v Mortell 1986 No 20 Sp, IAJ. Costello J stated:

"*It is not every error of judgment that amounts to misfeasance in law and it is not every act of negligence that amounts to misfeasance in law. It seems to me that something*

more than mere carelessness is requires, some act that, perhaps, may amount to gross negligence in failing to carry out a duty owed by a director to his company."

29. I respectfully decline to follow this decision, which is not consistent – and there is no reason why it should be – with the English case law. A negligent breach of duty by a director which has caused loss to the company is sufficient to found an action for misfeasance. The negligence need not be gross.

30. Re D'Jan of London Ltd [1993] BCC 646 Ch D provides an example of a negligent breach of duty by omission which is closer to the facts of the instant case. The liquidator issued a summons under section 212 of the Insolvency Act 1986 ("the 1986 Act") – which is analogous to section 247(1) of the 1981 Act – alleging that the respondent director was negligent in completing and signing a proposal form for fire insurance, with the result that the insurers repudiated liability for a fire in which stock said to be worth some £174,000 was destroyed. The question "*Have you or any director or partner … been director of any company which went into liquidation?*" was answered "*no*" when the correct answer was "*yes*". The respondent admitted that the answer was incorrect but gave evidence that he did not fill in the form himself or read it before he signed it.

31. Hoffmann LJ (as he then was)[1] found that the respondent was liable to compensate the company for the loss caused by his breach of duty, although not to the full extent of the loss. In failing even to read the form he had negligently breached his common law duty of care to the company. Hoffmann LJ stated at 648 B – C:

"*I accept that in real life, this often happens. But that does not mean that it is not negligent. People often take risks in circumstances in which it was not necessary or reasonable to do so. If the risk materialises, they may have to pay a penalty.*"

32. Although analogous to section 247(1) of the 1981 Act, section 212 of the 1986 Act is expressed in broader terms in that it applies to officers and

[1] Sitting as an additional judge of the Chancery Division.

others who have "*been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company*". However I am satisfied that the outcome in Re D'Jan of London Ltd would have been the same under section 247(1) of the 1981 Act as the case involved a breach by a director of the duty which he owed in that capacity to the company.

33. On the face of it, the failure of the Defendants in the present case to ensure continuity of workers' insurance cover when they were under a statutory duty to do so is a paradigmatic case of a collective failure by the directors of a company to carry out their duties with reasonable care and skill. They have not tendered any evidence to suggest otherwise, eg to show that they had done everything that they reasonably could to ensure that there was no break in the insurance cover. I am therefore satisfied that each of the Defendants breached the duty to perform his duties with reasonable care and skill which he owed to the Company.

34. As a result of those breaches, the Company has suffered a loss in that it has incurred a liability to pay the judgment awarded against it in Peiris v Bermuda Building Services Company Ltd. I am therefore satisfied that – to use the language of section 247(1) of the 1981 Act – all three Defendants have been guilty of misfeasance in relation to the Company. This finding is made without prejudice to the terms of an indemnity in the Company's bye-laws, which I shall consider later in this judgment.

Should the Court relieve the Defendants from liability?

35. The Defendants urge me to make an order under section 281(1) of the 1981 Act relieving the Defendants from any liability. This provides:

"*If in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor, whether he is or is not an officer of the company, it appears to the Court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust,*

that Court may relieve him, either wholly or partly, from his liability on such terms as the Court may think fit."

36. As section 281(1) contemplates relief from liability in a case of negligence, it follows that conduct may be reasonable for the purposes of the section notwithstanding that it amounts to lack of reasonable care at common law. In Re D'Jan of London Ltd at 649 A – B, Hoffmann LJ expressly acknowledged that this was so in relation to the analogous section 727 of the 1986 Act.

37. Nonetheless, whereas I accept that the Defendants have acted honestly, I do not accept that in permitting the lapse of workers' insurance cover they have acted reasonably in any meaningful sense of the word. I therefore decline to make an order under this section.

Is there an applicable indemnity?

38. Article 124 of the Company's bye-laws contains an indemnity in favour of its directors. The article provides:

"*Subject to the proviso below, every Director … shall be indemnified out of the funds of the Company against all civil liabilities loss damage or expense (including but not limited to liabilities under contract, tort and statute or any applicable foreign law or regulation and all reasonable and other costs and expenses property (sic) payable) incurred or suffered by him as such Director …. PROVIDED ALWAYS that the indemnity contained in this Bye-Law shall not extend to any matter which would render it void pursuant to the Companies Acts.*"

39. As to matters which would render an indemnity void, the relevant statutory provision is now section 98 of the 1981 Act. This provides in material part:

"*Subject to subsection (2), a company may in its bye-laws or in any contract or arrangement between the company and any officer, or any person employed by the company as auditor, exempt such officer or person from, 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 or person may be guilty in relation to the company or any subsidiary thereof.*

Any provision, whether contained in the bye-laws of a company or in any contract or arrangement between the company and any officer, or any person employed by the company as auditor, exempting such officer or person from, or indemnifying him against any liability which by virtue of any rule of law would otherwise attach to him in respect of any fraud or dishonesty of which he may be guilty in relation to the company shall be void:"

40. There is therefore no statutory bar to the bye-laws of a company indemnifying the directors for any conduct in relation to that company short of fraud or dishonesty. As fraud or dishonesty is not alleged against the Defendants, I am satisfied that they are in principle covered by the indemnity in the Company's bye-laws.

Are the Defendants entitled to rely on the indemnity?

41. In order to satisfy myself that the Defendants are entitled to rely on the indemnity there are a couple of issues which I need to consider. The first is whether the Defendants have a contractual entitlement to rely on the bye-laws. The applicable principles were stated succinctly by Stanley-Burnton J in Globalink Telecommunications Ltd v Wilmbury Ltd [2002] BCC 958 at para 30:

"*The articles of association of a company are as a result of statute a contract between the members of a company and the company in relation to their membership. The articles are not automatically binding as between a company and its officers as such. In so far as the articles are applicable to the relationship between a company and its officers, the articles may be expressly or impliedly incorporated in the contract between the company and a director. They will be so incorporated if the director accepts appointment 'on the footing of the articles', and relatively little may be required to incorporate the articles by implication: per Ferris J at para. 26 of his judgment [in John v PricewaterhouseCoopers [2002] 1 WLR 953]*."

42. In the present case, which involved a small family company, I draw the reasonable inference that the Defendants accepted appointment as directors on the footing of the indemnity in article 124.

43. The second issue is whether, notwithstanding that their conduct is covered by the indemnity, the Defendants are precluded from relying on it. They owe the Company a fiduciary duty of care not to claim an indemnity against loss arising from their wilful neglect or default, *per* Smellie CJ in In the matter of Bristol Fund Limited 2008 CILR 317 Grand Ct at para 75. But the Company's loss arose from the Defendants' inadvertence. In my judgment this did not amount to wilful neglect or default. So their fiduciary duty of care does not prevent them from relying on the indemnity.

44. I am therefore satisfied that the Defendants are entitled to rely upon the indemnity in the Company's bye-laws.

What is the effect of the indemnity?

45. Article 124 does not purport to exempt the Company's directors from liability but rather to indemnify them in respect of it. However the legal consequence would be the same in either case. A company has no cause of action against a director in respect of a matter in which the company has agreed to indemnify him.

46. The Privy Council so held in Viscount of Royal Court v Shelton [1986] 1 WLR 985. The principal question on appeal was whether a director could rely on an indemnity clause 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.

47. The indemnity clause in question, which was article 46 of the bye-laws, was described at 988 E by Lord Brightman, who gave the judgment of the Board, as "*a somewhat confusing jumble of verbiage*". He broke it down into its component parts, which at 988 F included the following:

> "*(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 …*"

48. The Board held that the directors were fully protected by the indemnity. Lord Brightman stated at 991 E – F:

> "*The directors, as a matter of construction of article 46, 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*** *[Emphais added]*."

49. Lord Brightman's reasoning was part of the *ratio* of the case, as one of the reasons why the Board found that the directors were not liable under article 46 for the loss which happened to the company, and is binding upon me.

50. The Plaintiff seeks to distinguish this decision. He submits that an indemnity in a company's bye-laws cannot apply in the case of a misfeasance application because the loss complained of is that of the creditors. But that is not correct. As held in Coventry and Dixon's Case, which is mentioned above, a misfeasance action is a summary procedure for bringing an action which could have been brought by a company had it not been wound up. Accordingly, a plaintiff in a misfeasance application cannot be in a better position in relation to the enforcement of a directors' indemnity than the company itself would have been.

51. Thus in the City Equitable case both the directors and the auditors successfully relied on an indemnity in article 150 of the company's bye-laws to defeat a misfeasance application. Warrington LJ stated in the Court of Appeal at 526:

> "*if therefore there is some act or omission on the part of the auditors which, having regard to the provisions of art. 150 in the present case, or to a similar article in any other case, does not give rise to any liability to the company, then in my opinion it gives rise to no liability under s. 215. I think that is made perfectly plain, especially by the speech of Lord Macnaghten in Cavendish Bentinck v. Fenn 12 App. Cas. 652.*"

52. The Plaintiff referred me to a passage in In re Etic at 870 where Maugham J stated:

> "*It is settled law that no set-off is permissible to an officer of a company on an application under s. 215. That was decided first, I think, in the case of Ex parte Pelly 21 Ch. D. 492.*"

53. But this passage does not avail the Plaintiff. The learned judge was not suggesting that in the case of a directors' indemnity a director would have to pay the company the monies owing to it before reclaiming them under an indemnity – which would imply that notwithstanding the indemnity the company had a right of action against him.[2] Rather, he was referring to a situation where independently of any indemnity a director has a right of action against the company. In such a case the director cannot offset the monies claimed under that cause of action against the monies claimed on a misfeasance summons. Specifically, Maugham J was explaining that the respondent company secretary could not offset his claim for three months' salary in lieu of notice against the company's claim that he was indebted to the company for the expenses of a visit by him to America and for sums overdrawn on account of his salary.

54. I therefore find with respect to the misfeasance application that the Defendants are covered by the indemnity in the bye-laws and that consequently the Company has no cause of action against them. The fact that the claim is not brought by the Company but under section 247(1) of the 1981 Act by a creditor is immaterial. As the Plaintiff can show no cause of action by the Company against the Defendants, the misfeasance action is bound to fail.

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[2] That is in any case not how indemnities work. See the speech of Lord Goff in "The Fanti" [1991] 2 AC 1 at 36 B – C: "*Equity does not mend men's bargains; but it may grant specific performance of a contract, consistently with its terms, where the remedies at law are inadequate. This is what has happened in the case of contracts of indemnity. As a general rule, 'Indemnity requires that the party to be indemnified shall never be called upon to pay' (see* ***In re Richardson*** *[1911] 2 K.B. 705, 716, per Buckley L.J.); and it is to give effect to that underlying purpose of the contract that equity intervenes, the common law remedies being incapable of achieving that result.*"

55. The Plaintiff's action is therefore dismissed. Although the Defendants are the successful parties they have indicated that they do not seek an order for costs. In the circumstances, I would propose to make no order as to costs. However, if either party wishes to address me as to costs I shall, of course, hear them.

Dated this 4th day of March, 2015

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Hellman J