

Duties of company directors under Bermuda law

Briefing Summary: The directors of a Bermuda company owe certain duties to their company when fulfilling their responsibility to oversee the management of the company. That includes both fiduciary duties which are rooted in honesty and loyalty to the company, as well as a non-fiduciary duty of care, diligence, and skill which is rooted in competence. The types of duties owed by directors under Bermuda law are fairly straightforward, but the scope and requirements of those duties are more nuanced. Given that the consequences of a breach of duty can include civil financial penalties as well as criminal conviction, it is imperative that Bermuda directors fully understand and comply with their duties to the company.

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Company directors constitute fiduciaries under Bermuda law and therefore owe various duties to their company. The duties owed by the directors are founded in both legislation and the common law. Those duties are both fiduciary and non-fiduciary in nature. The fiduciary duties are equitable and, at their most basic, require a director's absolute honesty and loyalty to their company.

The duties imposed on Bermuda directors are generally derived from and are consistent with the English common law duties prior to the codification of the English duties in the UK's *Companies Act 2006*. The Bermuda law directors' duties have somewhat diverged from their English common law origin since then. However, the Bermuda courts will often look to the English common law when interpreting the scope and requirements of the duties imposed on directors under Bermuda law. It is therefore important for directors to know what their precise duties are under Bermuda law, but also to have a proper understanding of the requirements of those duties, which can only be discerned through a fulsome review of the common law and the relevant facts.

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List of directors' duties

The duties of company directors under Bermuda law are primarily governed by the *Companies Act 1981* (the "**Act**") and the common law, which together set out the powers and obligations of Bermuda directors. Section 97 of the **Act** imposes the following two statutory duties on the directors of a Bermuda company:

- **Section 97(1)(a) – Duty of good faith:** Directors owe a fiduciary duty to act honestly and in good faith with a view to the best interests of the company.
- **Section 97(1)(b) – Duty of care:** Directors owe a non-fiduciary duty to exercise the care, diligence, and skill that a reasonably prudent person would exercise in similar circumstances.

While section 97(1) of the **Act** sets out the nature of directors' statutory duties under Bermuda law, the scope of those duties remains subject to the requirements of the common law. The common law otherwise imposes the following fiduciary duties on the directors of a Bermuda company:

- **Duty of good faith:** This is effectively the same fiduciary duty to act in good faith and the best interests of the company as has been codified in section 97(1)(a) of the **Act**.
- **Duty to act for a proper purpose:** Directors owe a fiduciary duty to exercise their powers for a proper purpose in accordance with the company's governance documents (such as the bye-laws).
- **Duty to avoid conflicts:** Directors owe a fiduciary duty to avoid conflicts between their personal interests and the interests of the company.

It is important to note that directors' duties under Bermuda law are owed to the company rather than to the company's registered shareholders individually (which are referred to as "**members**" under the **Act**). Directors must therefore act to promote the success of the company for the benefit of the company as a whole, which effectively means for the benefit of all current and future registered shareholders, except in certain special circumstances.

For example, when a company is insolvent or likely to become insolvent, the duties generally shift to require directors to act in the best interests of the company for the benefit of the company's creditors as a whole. There are also various statutory offences and penalties applicable to directors in the context of company insolvency, which are set out in sections 243-248 of the **Act**. Some of those offences can result in directors being criminally prosecuted for wrongdoing which occurs while the company is insolvent.

There are also certain duties imposed on directors in industry-specific contexts. For example, the *Insurance Act 1978* and the Bermuda Monetary Authority's *The Insurance Code of Conduct* impose differing duties on directors of Bermuda insurers and insurance groups, such as requiring directors to act with a view to the best interests of both the insurance company and its policyholders.

Given that the nature of directors' duties may shift in certain critical situations (such as when the company experiences financial difficulties), it is important for directors to seek Bermuda legal advice as soon as such a critical situation becomes a realistic possibility. The potential personal legal jeopardy for a company's directors only increases as the company's situation becomes more critical.

Scope and requirements of directors' duties

The *Act* codifies certain common law directors' duties and imposes other limited requirements on the exercise of those duties. However, the precise requirements of directors' duties under Bermuda law are otherwise governed by the common law and may depend on the interpretation of the Bermuda courts based on the factual circumstances. For example, directors are likely to be found to have committed a misfeasance in breach of their duties to the company if the directors authorise the use of the company's resources to improperly litigate a dispute among the company's shareholders or directors. The company must generally remain neutral and becomes a nominal party in shareholder or director disputes.

With that said, the common law has generally interpreted the requirements of directors' duties as follows.

Duty of good faith

The duty of good faith requires directors to act in a manner which the directors subjectively consider most likely to promote the success of the company for the benefit of its registered shareholders as a whole. How to best promote the success of the company is a determination that the directors are responsible for making on an ongoing basis. For example, the duty of good faith may require directors to self-disclose their own wrongdoing, as well as the wrongdoing of their fellow directors, if doing so is in the company's best interests.

The Bermuda courts will generally give directors considerable latitude to exercise their own ordinary business judgment in managing the company, as long as that business judgment is being exercised in good faith. If a breach of the duty of good faith is alleged, the party alleging the breach has the onus of proving the directors have committed a breach by, for example, pursuing their own self-interests to the detriment of the company. If the alleged breach is litigated, the Bermuda courts will objectively consider whether what the directors have done can reasonably be considered as being in the best interests of the company.

Duty of care

Directors are required to manage the company with a requisite level of skill and care. The duty of care generally requires directors to act with the level of skill of a person with similar knowledge and experience, diligently attend to the management of the company based on a reasonable standard of care expected of a person in the same circumstances, and delegate their responsibilities only to third parties with the requisite skill required to fulfil those responsibilities, as well as ensure the directors' delegates are properly supervised.

The duty of care is a non-fiduciary duty which is concerned with competence rather than honesty and loyalty. The wording of section 97(1)(b) of the *Act* indicates that this duty imposes an objective standard of care similar to that imposed under the English common law, which is consistent with how the Bermuda courts have recently interpreted this duty. Whether directors have met the required standard of care will invariably depend on the circumstances and their own knowledge and qualifications, but a breach can occur through the actions or omissions of directors.

Practically, directors are entitled to reasonably delegate their responsibilities in governing the company to competent and qualified third parties. That ability is codified in section 97(5A) of the *Act*, which prevents directors from being held liable for good faith actions taken based on representations made by other apparently competent company officers and third party professionals (such as lawyers and accountants). However, that does not permit directors to entirely abdicate their responsibilities and liabilities to others. Directors must still fulfil their duty of care by properly supervising those to whom the directors have delegated the responsibility to manage the affairs of the company.

Duty to act for a proper purpose

Directors are required to exercise their powers under the company's constitutional documents for their intended purpose and not for any collateral purpose. That determination requires an objective consideration of the intended purpose of the power in question, as well as the directors' actual purpose in exercising the power. In other words, whether directors have acted for a proper purpose is a determination that must be made based on the factual circumstances in which a particular action is taken.

The duty to act for a proper purpose may also overlap with the duty of good faith, but it is not the same. Directors who are subjectively acting in good faith can still be found to have acted for an improper purpose. For example, directors will not automatically be found to have acted for a proper purpose simply because they subjectively believed they were acting in the best interests of the company and were not seeking to promote the interests of a certain shareholders over the interests of other shareholders.

The duty to act for a proper purpose often becomes most relevant in the context of a shareholder dispute. For example, directors may be found to have breached this duty if they use their powers under the company's bye-laws to improperly influence the outcome of a general meeting of the shareholders. Directors may also be found to have acted for an improper purpose if they prevent the company's shareholders from electing directors to replace them or exclude validly elected directors from the management of the company.

Duty to avoid conflicts

Directors are required to avoid circumstances in which their personal interests may conflict with the interests of the company. That requires directors to disclose any real or potential conflicts and to refrain from acting in relation to any conflicted matters unless authorised to do so in advance. A company's bye-laws will generally govern conflicts of interest, which may allow directors to continue to act so long as they disclose any conflicts to the company, the other directors do not object, and the director in question is satisfied that they can continue to act in the best interest of the company notwithstanding the conflict (but whether the director should, in fact, act must always be assessed on a case-by-case basis).

The duty to avoid conflicts specifically requires directors to disclose their interests in any "*material contracts*" with their company, its subsidiaries, or any third party which is contracting with their company. If disclosure is not made at the first opportunity, section 97(4)(b) of the *Act* automatically deems the directors not to have been "*acting honestly and in good faith*." Directors are also prohibited from acting for profit on any business opportunity, or using any commercial advantage, that they become aware of in their capacity as directors. That applies even if the company itself cannot otherwise exploit the opportunity or advantage.

A conflict of interest can also arise in relation to both direct and indirect interests. For example, a director who sits on the board of several companies may encounter a conflict between the separate duties they owe to each company. That is why directors are generally prohibited from serving on the board of two competitor companies unless otherwise explicitly authorised to do so.

Practically, the duty to avoid conflicts prohibits directors from unquestionably taking instructions from other entities in their corporate group without also considering the best interests of their own company. It also prohibits directors from sharing their company's confidential information with third parties without prior authorisation to do so. For example, directors appointed to the board by shareholders based on explicit rights set out in the company's bye-laws or shareholders' agreement must still keep the company's information confidential. That includes keeping the information confidential from the shareholders that appointed the directors, unless expressly authorised to share that information (e.g., through the company's bye-laws or in its shareholders' agreement).

Consequences of breach of directors' duties

A breach of duty can result in personal liability for directors, including an award of monetary damages or even criminal conviction. A breach can also result in various consequences for the company itself which arise from and are related to the wrongful acts of the company's directors, such as the invalidation of corporate actions taken by the company as a result of its directors' breach of their duties.

A breach of duty will usually be enforced by the company itself through a legal claim against the wrongdoing director personally. The company itself must generally bring such a claim because directors owe their duties to the company. Bermuda law therefore restricts the ability of shareholders and other third parties to bring claims against directors for breach of their duties to the company, except in certain special circumstances.

For example, liquidators may be able to bring a legal claim against then-former directors personally on behalf of the company's creditors for a breach of duty which occurs while the company is insolvent or likely to become insolvent. That is because, in the insolvency context, directors' duties generally shift to require the directors to act in the best interests of the company for the benefit of the company's creditors as a whole. Directors can also be held personally liable for failing to pay the company's taxes and pension contributions in the face of the company's insolvency.

Additionally, shareholders may be able to commence a derivative claim on behalf of the company against its directors for breach of duty. However, after filing the claim, the shareholders must seek leave from the Bermuda courts to continue the derivative claim. There are limited circumstances in which a derivative claim is appropriate. For more on the legal claims available to shareholders and directors under Bermuda law, please see our previous briefing [here](#).

Section 98(2) of the *Act* prohibits a company from indemnifying its directors under the bye-laws or any other agreements for personal expenses incurred in relation to a breach of duty which involves fraud or dishonesty. That statutory prohibition is usually reflected in the bye-laws of a Bermuda company.

There are further circumstances in which directors may be prevented by the common law from seeking indemnification from the company for personal expenses incurred in relation to a breach of duty. For example, directors who are found to have committed a misfeasance due to improperly using the company's money to defend a shareholder derivative claim or unfair prejudice/oppression claim may be prohibited from seeking indemnification under the company's bye-laws for any related expenses.

Conclusion

The specific duties imposed on directors under Bermuda law are fairly clear, although the scope and requirements of those duties are more nuanced and can change depending on the circumstances. It is therefore important for directors to understand the nature of their duties to the company and know when to seek independent legal advice to clarify the scope and requirements of those duties. Otherwise, the failure by directors to properly understand and comply with their duties can result in consequences ranging from personal civil liability to criminal conviction. An experienced legal advisor is key to avoiding such consequences, which is in the best interests of the directors personally as well as the company itself.

FAQs

1. What duties do directors of a Bermuda company owe?

Directors owe both fiduciary duties (to act in good faith, for a proper purpose, and to avoid conflicts) and a non-fiduciary duty of care, diligence, and skill. These duties arise from the *Companies Act 1981* and common law.

2. Who do directors owe their duties to?

Directors owe their duties to the company itself, not to individual shareholders. Their role is to act to promote the success of the company as a whole, which means benefiting all current and future shareholders, except in certain special circumstances.

3. What do the fiduciary duties require?

The fiduciary duties require directors to do the following:

- Act honestly and in good faith with a view to the best interests of the company.
 - Exercise their powers for a proper purpose in accordance with the company's governance documents.
 - Avoid conflicts between personal interests and the interests of the company.
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4. How does the duty of care apply to directors?

Directors must act with the level of skill of a person with similar knowledge and experience, diligently attend to the management of the company based on a reasonable standard of care expected of a person in the same circumstances, and delegate their responsibilities only to third parties with the requisite skill required to fulfil those responsibilities.

5. What are the consequences of breaching directors' duties?

A breach of duty can result in personal liability for directors, including an award of monetary damages or even criminal conviction. A breach can also result in various consequences for the company itself which arise from and are related to the wrongful acts of the company's directors, such as the invalidation of corporate actions taken by the company as a result of its directors' breach of their duties.

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