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Transitional provisions, Guernsey companies law

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Introduction

The States of Guernsey radically reformed Guernsey's companies law in 2008 with the repeal of the Companies (Guernsey) Law, 1994 (the "1994 Law") and the introduction of the Companies (Guernsey) Law, 2008 (the "2008 Law").

This reform involved a shift away from a "capital maintenance" model of company law to a more flexible and commercially sensible "solvency model" of company law.

Such a shift, while welcome and extremely useful for Guernsey companies, had profound implications for the structure and content of the memoranda and articles of companies incorporated under the terms of the 1994 Law.

The transitional provisions

Given these profound implications, and the understanding that they would take time to "bed down", the States of Guernsey wanted to provide the users of Guernsey companies with some breathing space before such users might be required to update their memoranda and articles.

This breathing space was offered by the Companies (Transitional Provisions) Regulations, 2008 (the "Transitional Provisions").

The effect of the Transitional Provisions was to suspend the coming into force of portions of the 2008 Law until the deadline set out in the Transitional Provisions.

The key elements of these Transitional Provisions were sections 2 and 3, which provided that where a Guernsey company's memorandum or articles were valid under the 1994 Law but would be rendered invalid under the 2008 Law, such provisions would continue to be valid notwithstanding the provisions of the 2008 Law until the deadline set out in the Transitional Provisions.

The 2008 Law took longer than anticipated to "bed down" and the Transitional Provisions have been extended since 2008 until now.

However, the final element of the "bedding down" of the 2008 Law fell into place in September 2015 when the Companies (Guernsey) Law, 2008 Amendment Ordinance, 2015 (the "Amendment Ordinance") came into force. The Amendment Ordinance corrected many of the issues with the 2008 Law which had been noted by the finance industry.

Following the Amendment Ordinance coming into force in September 2015, the States of Guernsey indicated that there will be no further renewals of the Transitional Provisions and that on 30 December 2016 the "time limited" Transitional Provisions will expire.

Categorisation of affected companies

In order to clearly explain the implications of the Transitional Provisions coming to an end, Guernsey companies have to be categorised into one of the following four categories:

- firstly, companies incorporated under the 1994 Law whose memoranda and articles have not been updated to take account of the 2008 Law ("Category 1 Companies");
- secondly, companies incorporated under the 1994 Law whose articles have been updated to take account of the 2008 Law, but before September 2015* ("Category 2 Companies");

- thirdly, companies incorporated under the 2008 Law, but before September 2015* ("Category 3 Companies"); and
- fourthly, companies incorporated under the 2008 Law, during or after September 2015* ("Category 4 Companies")

**September 2015 is relevant because the Amendment Ordinance came into force in September 2015*

Category 1 companies

The main (this is not an exhaustive list) areas of concern for Category 1 Companies are:

- the issuance of shares;
- the payment of dividends;
- the objects of the company;
- directors' indemnification; and
- changes to the practice and procedure for holding corporate meetings.

Issuance of shares and payment of dividends

As the 1994 Law was predicated on the notion of "capital maintenance", it contained a number of provisions which required Guernsey companies to maintain a stated amount of "authorised share capital".

These provisions included requirements that:

- the amount of the authorised share capital had to be stated in the memorandum and that no shares in excess of that amount could be issued without the voting shareholders authorising an increase to the authorised share capital by ordinary resolution; and
- save with the consent of the court, companies were forbidden from paying out monies representing the share capital account, the share premium account and the capital redemption reserve fund by way of dividend and could only pay dividends from "profits available for the purpose".

The 2008 Law radically altered these positions and:

- in respect of the issuance of shares, subject to the provisions of the memorandum and articles, the directors have the flexibility to issue an unlimited number of shares and shares of different classes without reference to the shareholders; and
- in respect of dividends, the directors of a company can now pay dividends where the company passes a statutory solvency test. Subject to the memorandum and articles, provided that the company is able to pay its debts as they fall due and that its assets exceed its liabilities, the company can pay any dividend either in cash or in specie.

The memoranda and articles of Category 1 Companies will contain a number of restrictions on the authorised share capital of the company, the issue of new shares and the payment of dividends. The directors of Category 1 Companies should consider carefully whether such restrictions serve any commercially useful purpose and may wish to now amend their memoranda and articles in order to take advantage of the flexibility offered by the new regime.

The objects of the company

In a similar vein, the 1994 Law required that companies maintain a list of stated "objects" in their memoranda and articles.

Such objects defined the purposes for which a company might exercise its powers, and any action of the company which exceeded the objects ran the risk of being considered "ultra vires" or beyond its powers.

This could result, amongst other potential outcomes, in transactions being set aside.

This led to the practice of companies adopting very lengthy lists of objects in an attempt to permit the directors the widest possible discretion.

The default position under the 2008 Law is that companies have unlimited objects, but this may be restricted by the memorandum and articles of a company.

Directors of Category 1 Companies with an enumerated list of objects should consider carefully whether they wish to eliminate that list and avail themselves of the greater flexibility offered by the 2008 Law.

Directors' indemnification

It was common practice under the 1994 Law for a company's articles to include clauses:

- exempting directors from liabilities incurred in the execution of their duties; and/or
- indemnifying directors from liabilities incurred in the execution of their duties.

This position was out of step with most common law jurisdictions and the 2008 Law amended it to bring Guernsey's law on the indemnification of directors into line with that found in the United Kingdom.

Under the 2008 Law:

- any provision of a company's memoranda or articles (or any other document) which excludes the liability of a director for, or indemnifies the director against liability in respect of, negligence, default, breach of duty or breach of trust in relation to the company is rendered void; and
- companies are permitted to pay for directors' and officers' insurance and to provide certain qualifying third party indemnities for directors.

Given that most 1994 Law compliant directors' indemnification provisions will simply be void under the 2008 Law, the directors of Category 1 Companies should consider carefully whether a 2008 Law compliant indemnity should be adopted.

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Changes to the practice and procedure for holding corporate meetings

Two of the guiding ideals behind the drafting of the 2008 Law were:

- promotion of administrative simplicity; and
- enhancement of shareholder protection.

These guiding ideals underpin certain amendments to the practice and procedure for holding corporate meetings and could result in clashes between the provisions of 1994 Law articles and the 2008 Law. Such potential clashes include the fact that:

- under the 1994 Law, corporate articles could restrict the use of written members' resolutions, whereas under the 2008 Law such restrictions are void;
- under the 1994 Law, corporate articles could restrict the votes that a proxy would have on a show of hands, whereas under the 2008 Law such restrictions are void;
- under the 1994 Law, corporate articles could provide for a differential between the numbers of votes cast on a written resolution and the number of votes cast on a poll, whereas under the 2008 Law such restrictions are void;
- under the 1994 Law, corporate articles could set the level of voting members required to demand a poll, whereas under the 2008 Law a 1994 Law company's articles are void to the extent that they would make ineffective a demand for a poll by at least 5 voting members; and
- under the 1994 Law, corporate articles could set the amount of time before a meeting that a form of proxy had to be received by, whereas under the 2008 Law a 1994 Law company's articles are void to the extent that they require a form of proxy to be received by the company earlier than 48 hours before the meeting.

The directors of Category 1 Companies should consider carefully whether the above are likely to be an issue in practice and whether 2008 Law compliant articles should be adopted.

Category 2 and 3 companies

Category 2 Companies and Category 3 Companies can be dealt with together as they should be in the same position, i.e. their memoranda and articles:

- have been amended to take account of the 2008 Law as it stood before the Amendment Ordinance; but
- have not been amended to take account of the Amendment Ordinance.

The main (this is not an exhaustive list) areas of concern for Category 2 Companies and Category 3 Companies arising out of the Amendment Ordinance are:

- the simplification of the original 2008 Law power to issue shares;
- the simplification of the directors' disclosures requirements;
- the clarification of the secretaries' duties provisions;
- the shortening of the notice periods when sending notices to shareholders; and
- the simplification of the process for the sending of documents by email.

The simplification of the original 2008 Law power to issue shares

The 2008 Law, as originally drafted, created a distinction between:

- companies which issued a single class of shares, whose directors had the power to issue an unlimited number of shares, subject to anything to the contrary in the articles; and
- companies which issued multiple classes of shares, who had to specify either in the memorandum or articles or in a resolution of the company, a 5 yearly authority to allot such shares specifying the maximum amount of shares to be issued pursuant to it and the date on which it would expire.

Companies incorporated between the 2008 Law coming into force and September 2015 will have this 5 yearly authority drafted into their articles (and many directly reference sections 292 and 293 of the 2008 Law).

The Amendment Ordinance amended the 2008 Law to remove the requirement for the 5 yearly authority and deleted sections 292 and 293 of the 2008 Law.

In order to benefit from this simplification, Category 2 Companies and Category 3 Companies will have to have their articles amended accordingly.

The simplification of the directors' disclosures requirements
Under the 2008 Law, as originally drafted, the disclosure of directors' interests process required the director in question to disclose:

- if the monetary value of the directors' interest is quantifiable, the nature and monetary value of that interest; or
- if the monetary value of the directors' interest is not quantifiable, the nature and extent of that interest.

Companies incorporated between the 2008 Law coming into force and September 2015 will have this reference to "monetary value" drafted into their articles.

The Amendment Ordinance amended the 2008 Law to simply provide for directors to disclose the "nature and extent" of their interests.

In order to benefit from this simplification, Category 2 Companies and Category 3 Companies will have to have their articles amended accordingly.

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The clarification of the secretaries' duties provisions

Under the 2008 Law, as originally drafted, section 171 provided a list of company secretarial duties, which applied no matter what the articles said and no matter what any relevant company administration agreement said.

The Transitional Provisions dis-applied section 171 of the 2008 Law so that it will not come into force until the deadline set out in the Transitional Provisions.

The Amendment Ordinance then amended the 2008 Law to provide that:

- the duties of the secretary are those assigned to him by the company's articles which may include the functions in section 171; and
- where by virtue of the articles the secretary's duties do not include the duties listed in section 171, those duties become the responsibility of the directors.

Given that most companies incorporated between the 2008 Law coming into force and September 2015 will simply have provisions stating that a company secretary may be appointed, the directors of Category 2 Companies and Category 3 Companies should give careful consideration to whether the articles should specify the secretary's functions or, more properly, should reference the company administration agreement between the company and the secretary in this regard.

The shortening of the notice periods when sending notices to shareholders

Under the 2008 Law, as originally drafted, the "deemed notice provisions" (i.e. the rules which regulate the day on which a shareholder is deemed to have received a notice sent by the company) provided that such a notice would be deemed to be received:

- in the case of a document sent to an address in the United Kingdom, the Channel Islands or the Isle of Man, on the third business day after the day of posting; and
- in the case of a document sent elsewhere, on the seventh business day after the day of posting.

The Amendment Ordinance amended the 2008 Law to:

- change the reference to "third business day" in the above paragraph to "second business day";
- change the reference to "seventh business day" in the above paragraph to "third business day"; and
- provide that the deemed notice provisions in the 2008 Law can be overridden by any deemed notice provisions in the articles, in
- respect of documents sent by the company to its members and by the members to the company.

Given that most companies incorporated between the 2008 Law coming into force and September 2015 will simply have provisions reflecting deemed notice of "three business days" / "seven business days", the directors of Category 2 Companies and Category 3 Companies should give careful consideration to whether the articles should be amended to refer to a shorter period of deemed notice.

The simplification of the process for the sending of documents by email

Under the 2008 Law, as originally drafted, documents sent by email were regarded as served when they were received.

This resulted in a degree of confusion as to when someone "receives" an email.

The Amendment Ordinance amended these provisions to provide that an email is regarded as served immediately after it is sent, unless the contrary is shown.

The directors of Category 2 Companies and Category 3 Companies should give careful consideration to whether the articles should be amended to reflect this clarification and promote the use of notification by email.

Category 4 companies

Category 4 Companies should not need to amend their articles because the Transitional Provisions and the Amendment Ordinance should have already been taken into account in the drafting of their memorandum and articles.

Do I have to amend the memorandum and articles before 30 December 2016?

The practical answer to that question is "it depends what the company in question does".

At one extreme end of the spectrum, if the company in question is a listed company, then the gold standard should apply and its constitutional documents should keep pace with legislative developments. It should therefore be looking to have its memoranda and articles updated at the annual general meeting before 30 December 2016.

At the absolute other end of the spectrum, if the company in question is a practically dormant single asset property holding vehicle (i.e. the typical Guernsey holding company which simply owns title to a residential property and doesn't do anything from year to year) there is probably very little necessity to rush to update its memoranda and articles.

In between these extremes there will be a graduated scale of companies for whom it becomes more and more sensible to update their memoranda and articles before 30 December 2016.

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The bottom line from a risk perspective is that provided sufficient care is taken, it should not be impossible to operate old articles under the 2008 Law. However, the chances of an administrator or company secretary overlooking a subtle difference between the old law and the new law, and a transaction subsequently being challenged or unwound, should be a powerful motivator to seek to update your memoranda and articles prior to 30 December 2016.

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