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Duties of directors of Jersey companies

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This note summarises the duties of directors of Jersey companies, addresses directors' indemnities, outlines some dangers for directors of insolvent or near-insolvent companies and provides some practical advice to directors of such companies to mitigate the risks.

Who is a director?

The Companies (Jersey) Law 1991 (the "Companies Law") states that a director is: "a person occupying the position of director, by whatever name called". Accordingly, you need not be formally appointed as a director to the company in order to owe the duties of a director. Alternate directors, shadow directors (to use an English term) and "other persons occupying the position of a director" (or 'de facto' directors) are subject to the duties and liabilities of being such, despite not being formally appointed.

What duties do I owe as a director, and to whom?

Articles 74, 75 and 76 of the Companies Law and the customary law.

All discussions about directors' duties in Jersey begin with Article 74 of the Companies Law. This requires that in exercising the directors' powers and discharging duties a director shall:

- act honestly and in good faith with a view to the best interests of the company; and
- exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

This is essentially an attempt to encapsulate the customary/ common law-derived fiduciary duties of directors, but which also remain relevant today (the above statutory statement not being exclusive).

These include:

Good faith

Under Jersey customary law directors have a duty to act bona fide in the best interests of the company. This is not a purely objective test. It imports the idea of what the particular director considers to be in the best interests of the company. This duty is reflected in Article 74(a) of the Companies Law. This duty is owed to the company and not to any other person, such as a shareholder, even a majority shareholder.

Proper purpose

Even if directors act in good faith and in the interests of the company, they must still use their powers for a proper purpose. An example often-quoted of a situation where directors have used their powers for an improper purpose is where directors issue shares, but do so to maintain or obtain personal control of the company in their capacity as shareholders.

Conflict between duty and interests (the "no conflict" rule)

The duty to avoid conflicts between personal interests and the duty to the company has largely been overtaken by statute. Article 75 of the Companies Law requires disclosure of direct or indirect interests in transactions entered into or proposed to be entered into by the company or by a subsidiary which to a material extent conflict or may conflict with the interests of the

company. The director must disclose at the first opportunity. You should also check the Articles because your company may have specific rules prohibiting interested directors from forming a part of a quorum or from voting on a matter in respect of which they have a conflict.

It is worth noting that if a director fails to disclose an interest then under Article 76 the company or member of the company can apply for an order setting aside the transaction concerned. The director can also be ordered to account to the company for any profit or gain realised. This leads us to the next customary duty:

Accounting for profits (the "no profit" rule)

A director's fiduciary position prohibits him from taking a personal profit from any opportunities arising from his directorship, even if he is acting honestly and for the good of the company. In such circumstances, profits made by the director on a transaction with the company or with a third party (arising from his position as director) need to be paid over to the company. This is the case even if it can be shown that the profit would not have accrued to the company. If the opportunity for the profit arose through the directorship then he must account to the company for it. Directors are only permitted to receive remuneration and payment of expenses if the Articles permit. Under Article 76 of the Companies Law the Jersey Court may direct that the conflicted director account for profits or gains realised from the transaction concerned.

Duty to participate in the company's affairs

Individual directors are under a positive and continuing obligation to participate in the company's affairs to some degree. The extent of the obligation will depend on (among other things) the role in the management of the company assumed by the director and the duties expected of a person in that role and the experience and skill of the particular director.

As a minimum requirement, each director must:

- generally, keep himself informed about the company's affairs (including the financial position of the company);
- be sufficiently informed about the company's business to enable him to perform his particular functions (if any);
- endeavour to attend, and participate in, all board meetings.

Prospectuses

The Companies Law in effect provides that anyone who fails to comply with the General Provisions Order (the "Order") issued under the Companies Law (and, where the offence is committed by a body corporate, every officer of the body corporate which is in default) is guilty of an offence punishable by imprisonment for a term not exceeding 2 years or a fine, or both.

The Order provides (among other things) that no person shall circulate a prospectus in Jersey (and no Jersey company may circulate a prospectus outside of Jersey) unless certain conditions are complied with.

Civil and criminal liability can also arise under the Companies Law for material statements in a prospectus that are untrue or misleading and also may arise as a result of material omissions from a prospectus. Criminal penalties include imprisonment for a term of up to 10 years or a fine, or both.

Financial Services (Jersey) Law 1998

There are other offences that a company director can commit, which fall outside of the scope of this note, but they include sanctions for market manipulation and insider dealing. There is currently no Jersey authority on actions based upon negligent misstatement, but Jersey law may recognise such an action. In reality though, if directors abide by the provisions of the Companies Law, and their other common/customary law duties, it is unlikely that common/customary law liability will arise.

Miscellaneous other duties of a company under the Companies Law

There are a variety of other statutory duties placed upon Jersey companies and the directors are responsible for ensuring these are met. These include:

- keeping registers of members, directors and secretary
- keeping minutes of meetings
- disposal of records after winding up
- holding of general meetings
- keeping of accounts
- appointment and removal of auditors (obligatory for all public companies)
- investigations of market traded companies
- filing of annual returns and special resolutions

Solvency statements

Redemption of shares

Redeemable limited shares of par value and no par value companies (not being open-ended investment companies) are capable of being redeemed from any source, but only if they are fully paid up and provided that all the directors of the company who authorise the redemption make a statement that they have formed the opinion:

- that, immediately following the date on which the payment is proposed to be made, the company will be able to discharge its liabilities as they fall due; and
- that, having regard to:
  a. the prospects of the company and to the intentions of the directors with respect to the management of the company's business; and
  b. the amount and character of the financial resources that will in their view be available to the company, the company will be able to:
     1. continue to carry on business; and
     2. discharge its liabilities as they fall due,

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until the expiry of the period of 12 months immediately following the date on which the payment is proposed to be made or until the company is dissolved pursuant to summary winding up, whichever first occurs.

A director who makes such a statement without having reasonable grounds for the opinion expressed in the statement is guilty of an offence punishable by up to 2 years imprisonment or a fine, or both.

Purchase of shares
The same solvency statement is required (and the same offence applies) with respect to the decision of a company to purchase its own limited shares under Article 57 of the Companies Law.

Distributions and reduction of capital
Under Part 17 of the Companies Law a "distribution" means "every description of distribution of the company's assets to its members as members, whether in cash or otherwise" but does not include a distribution by way of issue of shares as bonus shares, redemption or purchase of the company's shares (because they are dealt with under Articles 55 and 57), reduction of capital (because this is governed by Part 12) or a distribution to members on winding up. An almost identical solvency statement to that referred to above (incorporating the 12 month solvency look-forward) must be made by all of the directors who are to authorise the distribution.

A company may not make a distribution except in accordance with Article 115 if the distribution:

- reduces the net assets of the company; or
- is in respect of shares which are required to be recognised as a liability in the accounts of the company.

Article 115 permits a company to make such a distribution only if the directors who are to authorise such distribution make a solvency statement in respect of that distribution statement, both with reference to (a) the time immediately after the date the payment or the distribution is proposed to be made and (b) in respect of the period of 12 months immediately following the date on which the distribution is proposed to be made or until the company is dissolved under Article 150 (whichever occurs first), in order to be able so to reduce the company's capital or make such a distribution. Directors should note that each of the redemption of shares, purchase of shares and distribution processes require directors to form an opinion on the company's solvency. That opinion is required by law to be based upon the company's prospects, the directors' plans for the business and the amount and character of the financial resources available to the company. The opinion must be a reasonable one. The amount of due diligence directors need to do in order to form their opinion will depend on the facts and circumstances of the particular company concerned. However, by ensuring that the corporate governance, accounting, audit and treasury management functions are carried out appropriately, directors should have the raw data and information they need on which to base their opinion.

Warranty of authority

The doctrine of (external) ultra vires has been abolished in its application to Jersey companies. This means that a Jersey company cannot avoid liability to a third party under a contract entered into on its behalf by one of its directors simply by pointing to the fact that the company's memorandum or articles did not permit it to enter into such a contract.

Nevertheless, directors remain under an obligation to the company to conduct the business of the company in accordance with the memorandum and articles (internal ultra vires) and their general duties.

Where a director exceeds his actual authority (but acts within his ostensible or apparent authority):

- the company will be bound by the director's actions; and
- the company may have a claim against the director for damages for breach of authority.

If the director exceeds both his actual and his ostensible authority:

- the company will not be bound by the director's actions; but
- the director may still be liable for breach of warranty of authority to the third party; and
- he may also liable to the company itself for breach of authority.

Reliance on co-directors and officers

A director is not expected to attend every board meeting unless the articles specify this, but he ought to attend when able. Persistent non-attendance, however, is a breach of duty. A director must give a reasonable amount of attention to the company's affairs.

What that means in any particular case will depend upon a number of factors, including the number of directors on the board (responsibility of an individual on a smaller board is greater) and the extent to which areas of responsibility have been allocated among directors.

Directors are not expected to be experts in an area of business unless they are appointed because of their special qualifications. A director should be entitled to rely upon the advice of a fellow director as to matters on which that fellow director is regarded as being an expert. However, this does not mean that a director can vacate responsibility for (for example) accounting issues, claiming that it is not his or her area of expertise. Also, English case law, which is likely to be followed by the Jersey Court, shows that non-executive directors cannot simply leave management of a company to executive directors: non-executive directors pre-signed cheques for the use of an executive director and in that case all of the non-executive directors were held liable for negligence.

Directors must demonstrate such skill and care as may be reasonably expected from persons of their knowledge and

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experience, take such care as an ordinary person might be expected to in the conduct of their own affairs and exercise any and all powers in good faith in the best interests of the company.

As we set out below, every director must take steps to inform him/herself of the affairs of the company to a degree sufficient to enable him or her to discharge his/her fiduciary duty to act with a view to the best interests of the company. There are also specific duties for which a grasp of the financial circumstances of the company is crucial, including the approval of the accounts and the making of solvency statements such as those mentioned above where a company seeks to redeem shares, purchase its own shares, or make a distribution.

Indemnities for directors

There are limits on the indemnities that a company can provide to its directors. Article 77 of the Companies Law prohibits a company providing an indemnity to its directors, although there are exceptions:

- for liabilities incurred in defending civil or criminal proceedings where the director is successful or acquitted;
- for liabilities incurred otherwise than to the company where the director acted in good faith with a view to the best interests of the company;
- for liabilities incurred in connection with an application (which is successful) under Article 212 (power of court to relieve director from liability); and
- for liabilities normally insured against for persons other than directors (conventional "D&O" insurance).

Duties and offences in circumstances of insolvency

The topic of directors' duties becomes more complicated in the context of a company that is, or is near to becoming, insolvent. Directors of such a company are subject to additional duties and potential liabilities and may be required to take steps to safeguard the interests of the company's creditors. Failure to do so may lead to personal liability.

Wrongful trading – Article 177 Companies Law

The two main risks in an insolvency are wrongful trading and fraudulent trading. If you, as a director of a company, knew at a time prior to the date of commencement of a creditors' winding up (the "Winding Up") (or prior to the date of declaration of en désastre (the "Declaration") under the Bankruptcy (Désastre) (Jersey) Law 1990) that there was no reasonable prospect that the company would avoid such Winding Up or Declaration or on the facts known to you were reckless as to whether it would avoid it, then you may be held responsible (without limitation of liability) for all or any of the debts or other liabilities of the company arising after the time you had that knowledge. This offence is sometimes called "trading whilst insolvent", but the wording is crucial: it is not the mere fact of insolvency (meaning an inability to meet liabilities as they fall due) that is crucial, it is the point at which you knew that there was no reasonable prospect of the company avoiding a Winding Up or Declaration.

Fraudulent trading – Article 178 Companies Law

If it is shown that the business of a company is carried on with intent to defraud creditors of the company or of another person, or for a fraudulent purpose, the court may order that persons knowingly party to the carrying on of the business in that manner are liable to contribute to the company's assets as the court thinks proper. If that person is a creditor the court may direct that the whole or part of the debt owed is subordinated so that it ranks in order of payment after all other debts of the company.

This is without prejudice to the fact that a director may also be found criminally liable for the wrongful trading and fraudulent trading offences.

Transactions at an undervalue

The liquidator of a company and the Viscount (the Jersey Court's chief executive officer, appointed under the Bankruptcy (Désastre) (Jersey) Law 1990) can also challenge transactions entered into by a company at an undervalue. This is designed to target the dispersal of assets at nil or less than market value in the lead-up to insolvency either to related or unrelated entities. The period of time before the Winding Up or Declaration during which transactions are entered into, that may subsequently be liable to such challenge, is 5 years.

Preferences

Transactions that take place in the period of 12 months preceding a Winding Up or a Declaration may also be challenged by the liquidator or Viscount as a preference. The giving of a preference takes place where the company does anything or suffers anything to be done that has the effect of putting a creditor/surety/guarantor into a position which (in the event that the company is wound up or is subject to a Declaration) will be a better position than the one it would have been in if it had not taken place. The typical preference is where a distressed debtor provides security over its assets for a previously unsecured debt, or makes payment to one unsecured creditor in priority to another.

Practical steps

A director who exercises reasonable diligence and honesty is unlikely to find himself or herself liable for wrongful or fraudulent trading under Article 177 or Article 178 of the Companies Law. However there are a number of specific actions directors can take to try to mitigate risks:

- Obtain professional accounting and legal advice. Document it.
- Hold regular board meetings. Make sure minutes are taken and circulated, and that you as a director review minutes and correct anything you regard as requiring correction.
- Actively take steps to ensure you receive regular, up-to-date financial information.
- Article 177 looks to the moment in time at which directors knew the company no longer had a reasonable prospect of avoiding winding-up/désastre. To address this, directors should ensure that board minutes clearly document all

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potential sources of finance and options explored by the board, and put relevant dates against each such effort.

- The board may elect to set some milestones by which to measure the company's progress in trying to avoid a winding-up, such as by securing the payment of outstanding debtors or improvements in efficiency.
- The board should not incur substantial additional liabilities until other finance is secured.
- Directors ought to bring concerns to the attention of other board members and insist that steps are taken to minimise potential loss to creditors (Article 177(3)).

Related legislation

In addition to the Companies Law and the Order, please note that there are several pieces of domestic legislation which could impact upon the duties of a director of a Jersey company, a non-exhaustive list of which includes:

- Bankruptcy (Désastre) (Jersey) Law 1990;
- Financial Services (Jersey) Law 1998;
- Income Tax (Jersey) Law 1961;
- Investors (Prevention of Fraud) (Jersey) Law 1967; and
- Criminal Offences (Jersey) Law 2009.

Foreign laws/regulations

A director of a Jersey company may also be subject to the laws and regulations of another, foreign, jurisdiction, for example, by reason of being a director of a Jersey company which is carrying on a regulated business in or from within that jurisdiction, or which has a permanent establishment or equivalent in, or which is managed and controlled in or from within, that jurisdiction. Such foreign laws and regulations could also be relevant where a Jersey company has a subsidiary which is carrying on a regulated business etc. Applicable local legislation may hold directors, or responsible directors, accountable alongside their companies.

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