VOISIN LAW

Introduction

This note is intended to provide directors of Jersey companies with an overview of their principal duties, responsibilities and liabilities as well as the relief and indemnities that may be available to them.

It is essential that all directors have an understanding of their duties as a matter of Jersey law and that they recognise the risks associated with being a director before accepting office. The Companies (Jersey) Law 1991 (the "**Companies Law**") defines a director as "*a person occupying the position of director, by whatever name called*". Notwithstanding, therefore, the fact that a person may not have been formally appointed as a director of a Jersey company, that person may be treated by the Jersey Courts as exercising *de facto* control over the affairs of that company – such a person is sometimes referred to as a "shadow director".

Duties, Responsibilities and Liabilities

In this note the above is dealt with under the following non-exhaustive headings:

- General
- Issuing of a Prospectus
- Insider Dealing
- Insolvency
- Miscellaneous Personal Liabilities of Directors

General

The general duties and responsibilities of directors of a Jersey company are governed by:

- The Companies Law;
- The customary law; and
- The company's memorandum and articles of association.

The Companies Law

Article 74(1) of the Companies Law provides for the principal directors' duties, namely that a director, in exercising the director's powers and discharging the director's duties, 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.

It is possible for the shareholders of a company to sanction any action in contravention of Article 74(1), as will be outlined later in this briefing note.

The following are more specific statutory duties imposed by the Companies Law:

Duty to Disclose

Article 75 imposes upon a director a statutory duty to disclose to the company the nature and extent of his interest, whether direct or indirect, in any transaction entered into or proposed to be entered into by the company which, to a material extent, conflict with the interests of the company. This disclosure must be made as soon as practicable after the director becomes aware of the circumstances that give rise to his duty to make such disclosure.

Attention should also be paid to the company's Articles of Association as to the procedure for making such disclosures and whether or not the directors may vote at meetings considering matters in which they have an interest.

A failure to make the required disclosure of a director's interest, and follow the procedure in the Articles of Association with regard to voting, may permit the company or its members to apply to the Court under Article 76 to set aside the transaction and the director may have to account for any profits made.

It is therefore essential that if a director may have a disclosable interest, that he discloses the same (with sufficient particularity by reference to both Article 75 and any particular provisions contained within the Articles of Association) to the company. On a practical level, whilst it is not essential for the minutes to record that the directors have no interests, when undertaking transactions with third parties who will examine the minutes (for example banking transactions) it is prudent to include such a declaration as it will often be requested.

Duty to engage a suitable Company Secretary

Article 82 of the Companies Law imposes a duty on the directors of a public company to take all reasonable steps to secure a secretary who appears to them to have the requisite knowledge and experience to discharge the function of secretary of the company and who must also have the prescribed professional qualifications or capabilities to discharge that function. The prescribed professional qualifications can be found in the Companies (General Provisions) (Jersey) Order 2002.

Statutory Books

Under Article 41 every company shall keep a register of its members and enter in that register, *inter alia*, the names and addresses of its members together with, *inter alia*, a statement of the shares held and the amount paid up.

Under Article 83 every company shall keep a register of its directors and secretary containing, *inter alia*, each of their names and addresses.

A failure to comply either of the above Articles will result in the company and every officer of it who knowingly authorises or permits the default being guilty of an offence punishable by the imposition of the prescribed level of fine.

Customary Law

It should be noted that the Companies Law is not a codification of the laws of Jersey in relation to

companies. Therefore, in addition to the principal duties under Article 74 referred to above, directors of Jersey companies are under further duties under the general or customary law of Jersey, the most important of which can be summarised as follows:

Duty to act in good faith

A director can be held personally liable to the company (but not in general to its shareholders) for his acts or those of the company where he has not acted in good faith in what he considers to be the best interests of the company. This is a subjective test (therefore based upon what the director thought and believed at the time of acting). This duty is restated in (but not replaced by) the Companies Law under Article 74(1), as set out above. In keeping with the fiduciary role that a director holds, the Court will only infer that the director was not acting in good faith if no director acting reasonably could have believed that the course of action was in the best interests of the company.

The "best interests" to whose attention the director's mind should be drawn are those of the company and not anyone else (even another member of the same corporate group). '*For the benefit of the company*' can be taken to mean interests of its members present and future and thus the directors may balance a long-term view against short-term interests of existing members.

Duty to exercise powers for a proper purpose

Notwithstanding that the preceding duties may have been satisfied, directors must also use their powers for the purposes for which those powers were conferred. This is an objective test.

Examples include:

- A gratuitous transaction where the directors could not show sufficient *cause*, which is often indicative of improper purpose unless authorised by members (see *In re Zaki Limited 1987-88 JLR 244*);
- The issuance of shares to forestall a takeover bid is another example of an improper purpose of the powers conferred under the Articles of Association, given that the power to issue shares is granted for raising capital needed by the company (see *Bamford -v- Bamford (1970) Ch 212*);
- Although the Articles of Association may restrict the registration of the transfer of shares at the discretion of the directors this will be construed narrowly if that power is exercised for an improper purpose i.e. because the other directors wanted to acquire the shares (see *Baker -v- Falle 1991 JLR 284*).

Conflict of duty and interest

Whilst Article 75 of the Companies Law provides the main statutory framework for the regulation of conflicts of interest, the Companies Law is not a codification of the fiduciary responsibilities that burden directors in this regard and the myriad authorities in English law on the application of the conflict rule are highly persuasive before the Jersey Courts. Whilst the provisions of Article 75 are not identical to the equivalent provisions contained in Section 317 of the English Companies Act 1985, there is substantial congruence between the two laws.

Duty to account for profits

Directors' fiduciary duties toward the company precludes them from making personal profit from the use of the company's property without such use or profit being disclosed to the company, even if the director is acting honestly and for the good of the company. Any such profit is due to the company and the director is under a duty to account for it to the company. This aspect of a director's duties is consistent with general equitable principles that prohibit the holder of a fiduciary office from making a secret profit directly or indirectly from the holding of that office.

Breach of Warranty of Authority

Although the doctrine of *ultra vires* in its application to companies has been abolished, directors remain under an obligation to conduct the business of a company in accordance with its Memorandum and Articles of Association. Where directors acts outside of their authority, a third party dealing with those directors may have a direct right of action against those directors in question for breach of warranty of authority.

Memorandum and Articles of Association

The Memorandum and Articles of Association of the company are the foundation stones for the conduct of the affairs of the company and directors need to familiarise themselves with those documents. In particular, directors need to understand the extent and limitations of their powers and authorities that have been granted to them by the Articles of Association.

Duty to act within powers

The Articles of Association or resolutions of the company may provide certain authority, which must not be exceeded. It is not unusual for directors to have limited powers to, for example, borrow monies on behalf of the company. The Companies Law limits the extent to which directors can undertake certain affairs of the company by requiring either ordinary or special resolutions to be passed. Indeed, following a recent amendment to the Companies Law, it is now possible to prescribe in the Articles of Association of a Jersey company, that the required level of shareholder support for a special resolution is increased beyond the statutory minimum of a two-thirds majority. Furthermore, a shareholders agreement may further restrict the authority of directors with respect to the conduct of the company's business.

It is also worth noting that in older companies (pre-1991) the Memorandum of Association may also restrict the business that the company may undertake and therefore the directors must be mindful of any restrictions placed in this.

Issuing of a Prospectus

The Companies Law defines a prospectus as an "*invitation to the public to become a member of a company or to acquire or apply for any securities*". Generally speaking, a document offering shares in and debentures of a Jersey company (or any interests or rights therein) will constitute a prospectus, unless the following conditions are satisfied:

- The invitation is addressed to an identifiable category of persons to whom it is directly communicated by the inviter or his agent; and
- The members of that category are the only persons who may accept the offer and they are in possession of sufficient information to be able to make a reasonable evaluation of the invitation; and
- The number of persons in the Island or elsewhere to whom the invitation is so communicated does not exceed 50.

Article 29(1) of the Companies Law empowers the Jersey Financial Services Commission ("**JFSC**") to pass regulations prohibiting:

- The circulation of a prospectus in the Island
- The circulation of a prospectus, in the Island or elsewhere, by a Jersey company; and
- The procuring (whether in or outside the Island) by a company of the circulation of a prospectus outside of the Island.

An example of this power can be found in the Companies (General Provisions) (Jersey) Order 2002 ("**GPO**"). Under Article 5 of the GPO, no prospectus offering securities in a Jersey company shall be circulated in the Island or elsewhere unless:

- It contains the information and statements specified in Schedules 1 and 2 to the GPO;
- There has been delivered to the Registrar of Companies:
  - A copy of the prospectus, signed by or on behalf of all of the directors of the company;
  - A signed copy of any report included in, or attached to, the prospectus; and
  - Such other particulars as the Registrar may require; and
- The Registrar has given his consent to the circulation of the prospectus.

The Schedule to the GPO sets out the information to be specified in the prospectus and prescribes certain statements that must (in the absence of an express derogation from the Registrar) be included in the prospectus, including *inter alia* the following responsibility statement:

"The directors of the company have taken all reasonable care to ensure that the facts stated in this document are true and accurate in all material respects, and that there are no other facts the omission of which would make misleading any statement in the document, whether of facts or of opinion. All the directors accept responsibility accordingly."

Provided that the Registrar is satisfied that the deviation from including all the information and statements specified in the Schedules to the GPO does not affect the substance of the prospectus and is not calculated to mislead, it may give consent to the circulation of the prospectus.

Article 30 of the Companies Law provides for directors to make financial recompense to those suffering financial loss from a misleading statement in a prospectus published in connection with the issue of securities in a Jersey company without limit.

Directors of a listed company may be criminally liable if they are involved in misleading statements or practices, which may induce someone to buy or sell shares or other securities contrary to the relevant

provisions of the Companies Law or other relevant laws applicable to the marketing of securities.

Finally, the above duties are in addition to any requirements placed upon directors pursuant to the Collective Investment Funds (Jersey) Law 1998 and all subordinate legislation (a briefing note in respect of which can be found here), any requirements pursuant to a listing and any requirements which may be placed upon the company and directors by foreign laws regulating the marketing of securities.

Insider Dealing

Insider Dealing is a breach of director's duties and an offence under the Company Securities (Insider Dealing) (Jersey) Law 1998 ("**Insider Dealing Law**").

Articles 8 to 12 of the Insider Dealing Law set out the prevalent provisions relevant to directors of a company.

Article 8(1) of the Insider Dealing Law provides that an individual who is, or at any time in the preceding six months has been, knowingly connected with a company shall not deal on a recognised stock exchange in the securities of that company if he has information which:

- He holds by virtue of being connected with the company;
- It would be reasonable to expect a person so connected not to disclose except in the proper performance of the functions attaching to his position; and
- He knows is unpublished price sensitive information in relation to those securities.

However, Article provides that Articles 8 and 9 do not prohibit an individual, by reason of his having information, from, *inter alia*, doing any particular thing otherwise than with a view to making a profit or the avoidance of a loss (whether for himself or another person) by the use of that information provided that he does that thing in good faith in the course of his business.

Article 12 extends the prohibition imposed under Articles 8 and 9 to:

- Counselling or procuring any other person to deal with those securities in the knowledge or with reasonable cause to believe that that person would deal in the securities outside Jersey and Great Britain on any stock exchange other than a recognised stock exchange; or
- Communicating that information to any other person in the knowledge or with reasonable cause to believe that that person or some other person will make use of that information for the purposes of dealing counselling or procuring any other person to deal in the securities outside Jersey and Great Britain on any stock exchange other than a recognised stock exchange.

An individual who is guilty of an offence under Articles 8 or 12 of the Insider Dealing Law shall be liable to a fine and/or imprisonment for a term of up to 7 years.

Insolvency

Wrongful Trading

Article 177 of the Companies Law creates civil liability for wrongful trading where the Court may "*order that that person be personally responsible, without any limitation of liability*" for the liabilities of an insolvent company that have arisen at a time when the director knew that there was no "*reasonable prospect*" that the company would avoid a creditor's winding up, or on the facts known to him he was reckless as to whether the company would avoid such a winding up if that person was a director.

Article 177 does however include a proviso if the director "*took reasonable steps with a view to minimising the potential loss to the company's creditors*".

Article 45 of the Bankruptcy (Désastre) (Jersey) Law 1990 (the "**Désastre Law**") provides similar responsibility to that created by Article 177 of the Companies Law.

Directors need to be well informed and give due regard to their basic statutory obligations under Article 74 of the Companies Law at all times but they need to remain especially vigilant of these obligations where concerns of insolvency are on the horizon.

Fraudulent Trading

Article 178 of the Companies Law provides that in a creditor's winding up or in a corporate désastre or where it appears that the company's business has been carried on with intent to defraud creditors of the company or others, or for a fraudulent purpose, the Royal Court may make an order declaring that the company had traded fraudulently and may make parties knowingly involved liable to contribute to the company's assets, to the extent it thinks proper.

It would be necessary to prove an intention to defraud creditors of the company or another person and thus the standard of proof is high. There are no reported Jersey cases on Article 178 prosecutions.

Winding Up

A director who signs a statement of solvency in connection with a resolution to wind up the company without having reasonable grounds for that opinion is guilty of an offence (Article 150(7) of the Companies Law).

Where a company has redeemed or purchased shares less than one year before the commencement of winding up, and the payment was not made wholly out of profits available for distribution or out of proceeds of a fresh issue of shares made for the purpose of the redemption and purchase, and the aggregate realisable value of the company's assets and the amount paid by way of contribution to its assets is not sufficient for the payment of its liabilities and the expenses of the winding up, a director may be, subject to certain defences, personally liable to contribute to the company's assets so as to enable the insufficiency to be met (Article 181 of the Companies Law).

There are various other offences relating to the winding up of a company contained in Part XXI of the Companies Law which may result in a director who knowingly and wilfully authorises or permits the default becoming personally liable. These include, *inter alia*:

- Failure to publish notice of the passing of a special resolution for an insolvent winding up (Article 158);
- Failure to call a creditors' meeting and to present a statement as to the affairs of the company to that meeting (Article 160);
- After the commencement of an insolvent winding up but before the appointment of a liquidator, exercising the powers of the directors other than to call a creditors' meeting, to protect the assets of the company or with the sanction of the court (Article 164);
- Failure to co-operate with the liquidator (Article 183); and
- Failure to include on the company's correspondence a statement that the company is in liquidation (Article 191).

Miscellaneous Personal Liabilities of Directors

In addition to the specific duties and responsibilities listed above, directors may have personal liability in the follow circumstances:

Tortious Liability

Directors are agents of the company and therefore, under the general principles of agency, are at risk of being jointly and severally liable with the company for torts committed by it.

For a director to be liable for a tort committed principally through a company, it is considered that the director would have to have been involved in the decision making process that lead to the tortious conduct of the company.

Unlawful Financial Assistance

Given the abolition of the former Article 58 of the Companies Law pursuant to the Companies (Amendment No 2) (Jersey) Regulations 2008, the giving of financial assistance by a company, directly or indirectly for the purpose of, or in connection with, the acquisition made or to be made by any person of any shares in the company or where the company was a subsidiary, in any holding company of it, should not be of concern to directors in the future but directors may still be liable for breaches of the former Article 58 that occurred before its repeal.

Concern will still remain as to whether a transaction involving a shareholder could be construed as an unlawful distribution pursuant to Article 115 of the Companies Law. Under that Article directors need to make solvency statements and a director who makes such a statement without having reasonable grounds for doing so could face a term of imprisonment of up to two years or a fine or both (other consequences could also include a claim on the un-entitled shareholder for return of the unlawful distribution).

Often directors will be faced with related concerns as to the commerciality of the proposed transaction (which may or may not come within the definition of a "distribution") and in that event it is usual for the concerned director to seek a written resolution from all shareholders in order to take advantage of Article 74(2)(b) of the Companies Law which has the effect of relieving a director from conduct that would otherwise represent a breach of duty if all shareholders of the company authorize/ratify the act of omission

VOISIN LAW

and after that act or omission, the company will be able to discharge its liabilities as they fall due.

Acting whilst disqualified

If a person who has been disqualified as a director by the court (whether under Article 78 of the Companies Law or Article 43 of the Désastre Law, acts in breach of that order, either by acting as a director or taking part in the management of a company, he is personally responsible for the liabilities of the company incurred during that time. He is also guilty of an offence punishable by imprisonment for a term not exceeding two years and/or a fine.

Acting as a Director while Insolvent

Any person whose property is declared to be *en désastre* pursuant to the Désastre Law must forthwith upon such declaration resign any directorship he has. If he fails to do so, he commits an offence punishable by imprisonment for a term not exceeding six months and/or a fine.

Indemnities and Relief

Indemnities for Directors

The Companies Law makes it difficult for directors to be indemnified by the company if they have failed in any duty toward it.

Pursuant to Article 77(1) of the Companies Law, a company cannot make arrangements with directors (or auditors) to indemnify them against negligence, default, breach of duty or breach of trust in relation to the company and any such provision is void.

A company may indemnify a director for the costs of a civil/criminal defence if he acted in good faith and with a view to best interests of the company or where the company normally insures for persons other than directors and the company may purchase and maintain insurance for an officer for negligence, default, breach of duty or breach of trust in relation to the company.

However, an indemnity is allowed in certain circumstances, as follows:

"(2) Paragraph (1) does not apply to a provision for exempting a person from or indemnifying him against:

- *Any liabilities incurred in defending any proceedings (whether civil or criminal):*
    - *In which judgment is given in his favour or he is acquitted; or*
    - *Which are discontinued otherwise than for some benefit conferred by him or on his behalf or some detriment suffered by him; or*
    - *Which are settled on terms which include such benefit or detriment and, in the opinion of a majority of the directors of the company (excluding any director who conferred such benefit or on whose behalf such benefit was conferred or who suffered such detriment), he was substantially successful on the merits in his resistance to the proceedings;*
- *Any liability incurred otherwise than to the company if he acted in good faith with a view to the best interests of the company; or*

- *Any liability incurred in connection with an application made under Article 212 in which relief is granted to him by the court; or*
- *Any liability against which the company normally maintains insurance for persons other than directors."*

Relief for Directors

Article 74(2) of the Companies Law is the provision most often invoked to deal with breaches of fiduciary duty and provides a mechanism for the shareholders to forgive or authorise something that would otherwise be a breach of duty of a director. The statutory relief for a breach of the duties under Article 74(1) is set out under Article 74(2):

Without prejudice to the operation of any rule of law empowering the members, or any of them, to authorise or ratify a breach of this Article, no act or omission of a director shall be treated as a breach of paragraph (1) if:

- *All of the members of the company authorise or ratify the act or omission; and*
- *After the act or omission the company is able to discharge its liabilities as they fall due.*

The act or omission is forgiven provided that it is (1) authorised/ratified by all members and (2) after the act or omission the company is able to discharge its liabilities as they fall due and the realisable value of the company's assets is not less than its liabilities

It is a question of fact whether the solvency test referred to above is satisfied. If it is not then the act or omission remains a breach of the director's duty to the extent that it otherwise was such a breach.

Furthermore Article 74(3) permit shareholder resolutions to be passed either by resolution in writing or at a meeting which authorises or ratifies acts or omissions that would otherwise be a breach of fiduciary duty provided that (a) the requisite majority of votes is obtained and (b) after the act or omission in question the company will be able to discharge its liabilities as they fall due. There are various rules that do apply that restrict members "connected with" the relevant director from voting on these resolutions.

Article 212 of the Companies Law enables the court to relieve a director of liability in an action against him in certain circumstances as follows:

- *If in 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 it appears to the court 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 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, the court may relieve him, either wholly or partly, from his liability on such terms as it thinks fit.*
- *If an officer or person mentioned in paragraph (1) has reason to apprehend that a claim will or might be made against him in respect of negligence, default, breach of duty or breach of trust, he may apply to the court for relief; and the court on the application has the same power to relieve him as it*

> *would have had if proceedings against that person for negligence, default, breach of duty or breach of trust had been brought.*"

It is possible for a director to insure against liability to his company and to third parties, including shareholders.

Conclusion

Before accepting the office of director (or "*occupying the position of director, by whatever name called*"), it is vital that an individual director carries out a thorough due diligence exercise on the relevant company. This is particularly the case for non-executive directors who may have had no involvement at all in the company prior to the office of directorship. Moreover, the potential liabilities of a non-executive director are just as onerous as those of executive directors, although the non-executive director is unlikely to have the same ability to influence, manage or direct the company's activities and performance as his executive colleagues.

Directors should ensure that they are familiar with their duties under the relevant laws and the articles of association of the company. The business of the company will play a large part in determining the risk profile of the directorship. The obtaining of proper and adequate information on an ongoing basis as to the affairs of the company is essential. The concerns of a director of an investment holding company will be vastly different from those of a trading company. However, in each case the timely flow of information to the director will be of paramount importance in providing him with the ability to undertake his principal duty, which is to manage the affairs of the company.

For further information or specific advice on the use of Jersey Companies, please contact Ian Strang or Jeffrey Giovannoni of Voisin.

This note is intended to provide a brief rather than a comprehensive guide to the subject under consideration. It does not purport to give legal or financial advice that may be acted or relied upon. Specific professional advice should always be taken in respect of any individual matter.