THE DUTIES OF DIRECTORS UNDER JERSEY LAW

OCORIAN BRIEFING

February 2015

The text of this briefing is limited in its application to Jersey companies. This is a complex area of law not easily summarised into short form. It follows that this briefing should in no way be regarded as exhaustive.

Background

In accepting any directorship, a director will automatically assume a host of duties and personal obligations arising from specific legislation, common law and generally accepted standards of corporate governance. Drawing these duties and obligations together is not always an easy task, but notwithstanding this, the consequences of failure on individual directors can be severe. Recent high profile cases against individual directors (for example, the claims commenced by Equitable Life in 2005 against fifteen former directors in the sum of £3.7 billion) evidence that the stakes for individual directors have never been higher. It is therefore of paramount importance that individual directors fully appreciate and identify the risks associated with being a director and consider how these risks can best be mitigated.

Duties under Jersey law

No single piece of legislation exhaustively details or defines the duties of directors of a Jersey company. Articles 74 to 84 inclusive of the Companies (Jersey) Law 1991, as amended (the "Companies Law") collectively state some general provisions about appointment, removal, qualifications, duties and responsibilities of directors. Other more specific requirements are imposed on directors elsewhere in the Companies Law and in other legislation, notably the Bankruptcy (Désastre) (Jersey) Law 1990, as amended (the "Désastre Law"). Many of the most important features of directors' duties are, however, based on case law. To this extent, the Royal Court of Jersey will look to developed Jersey case law on the general question of directors' duties and, in the absence of such, will probably look for guidance to English common law.

Outside of the specific statutory duties, the main directors' duties are helpfully set out in Article 74 of the Companies Law, which provides that directors shall, in exercising their powers and discharging their duties:

"(a) act honestly and in good faith with a view to the best interests of the company; and

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

The general duties: honesty, diligence and others

The general statutory duties set out in Article 74 of the Companies Law reflect (though do not replace) the fiduciary and common law duties that had evolved prior to the Companies Law. The most important of these can be summarised as follows:

CONTINUED ON FOLLOWING

Honesty: Directors must not use their powers for an improper purpose, take personal advantage of the company's opportunities, misapply the company's assets, nor allow their personal interests to conflict with those of the company or, if they do, they must disclose the nature and extent of any actual or potential conflict of interest. A director holds a fiduciary position and the court will apply very stringent tests as to what constitutes impropriety, personal advantage or misapplication.

Proper purpose: Directors must use their powers under the company's articles of association for the purposes for which they were intended. An example of an improper purpose is directors using powers to issue shares, not to raise capital needed by the company, but to forestall a takeover bid (Bamford -v- Bamford [1970] Ch 212). In general, as soon as it is demonstrated that a company's asset has been applied by the directors for an improper purpose, the directors become personally liable.

Secret profits: If a director makes a personal profit through the use of the company's property without such use or profit being disclosed to the company, that profit is due to the company and the director is under a duty to account for it to the company. In the case of uncertainty, full disclosure to the board, followed by a resolution of shareholders ratifying the directors' actions, may help the situation. However, this may not assist in the event of insolvency or if a minority shareholder objects. Directors should consider taking legal advice before acting upon any opportunity that arises as a result of their position as directors.

Conflicts and declaration of interest: Directors are agents of the company and must use their discretion, but whatever decisions they take must be in the interests of the company and not for any collateral purpose, nor for a personal motive. Article 75 of the Companies Law requires disclosure by directors of the nature and extent of any interest they may have in a transaction which to a material extent conflicts or may conflict with the interests of the company. Pursuant to Article 76 of the Companies Law, where a director fails to disclose an interest or a conflict, the company itself or a shareholder may apply to the court to set aside the transaction. Individual directors may also have to account for any profits made, though not if the transaction is approved by special resolution of the shareholders.

Diligence: Subject to the constitutional documents of the company, the directors will be responsible for the conduct of the business of the company. Breach of a director's duty of care owed to the company may cause the director to be liable in damages to

the company for any loss suffered as a result of such breach. As a general duty of care, it is essential that directors be kept fully informed as to the financial position of the company (for example, by the finance director or the company's accountants). Directors should endeavour to attend all board meetings and to participate.

Specific duties arising from the Companies Law

It is the responsibility of all the directors of a company to ensure that a company meets its specific statutory obligations. In practice, the company secretary will often be appointed to ensure compliance with most of these obligations albeit the directors must ensure that the performance of the company secretary is duly monitored. These specific duties can be summarised as follows:

Disclosure of information: Companies are required to disclose information in a number of ways, such as filing annual returns, making available registers and documents, circulating reports and accounts to the shareholders etc.

Letterheads and stationery: Companies must include the company's name on all business letters, statements of account, invoices and other forms as well as details of the company's registered office address on all business letters and order forms.

Returns and filing with the Registrar: For a company to be incorporated in Jersey, the memorandum and articles of association, statement of particulars (giving the company's registered office) and completed control of borrowing ("COBO") application form (pursuant to which consent to issue the company's authorised share capital is granted) must be filed with the registrar of companies (the "Registrar").

In addition, all annual returns, special resolutions of shareholders, agreements between shareholders having the same effect as resolutions, all unanimous resolutions/agreements and notice of any change of the company's registered office must be filed with the Registrar.

Duties in relation to the company's accounts: A Jersey company is required to keep accounting records. Directors should ensure that this obligation is complied with. As part of a general duty of care, directors should always have a reasonably accurate idea of the financial position of the company, particularly in circumstances where the company is in financial difficulties.

Directors should also ensure that the accounts are prepared in accordance with Article 104 of the Companies Law (i.e. they must be prepared in accordance with a set of generally accepted accounting principles, show a true and fair view of the profit and loss of the company for the period, and state the company's affairs at the end of the period).

The company's annual accounts must be approved by the directors and signed on their behalf by one of them.

The directors must present the annual accounts for each financial year (together with the auditor's report where auditors are required) before the company in general meeting, within the period prescribed the Companies Law. If a private company has dispensed with the requirement to hold an annual general meeting, then the directors should lay the accounts before the next general meeting (if any) called in the next year.

There is no requirement to deliver the accounts and reports to the Registrar unless the company is a public company.

If the directors fail to comply with the Companies Law requirements, they may be guilty of a criminal offence. In addition, failure to keep and preserve proper accounting records is an offence under the Désastre Law.

Companies listed or applying for a full listing on any stock exchange must also satisfy the basic conditions for listing and comply with the relevant listing rules with which the directors should make themselves familiar.

Duties in relation to auditors: The statutory provisions relating to the appointment, removal, duties, powers and qualifications of auditors are found in Articles 103 to 113 of the Companies Law.

Auditors must be appointed where the company is a public company or its articles of association require, where a general meeting has so resolved and/or where the company is contractually bound to have its accounts audited.

The insolvency offences

The greatest risks faced by a director are likely to arise in the context of an insolvent or potentially insolvent company. As a matter of practice, individual directors face very real prospects of personal liability should they fail to perform their duties in the context of an insolvent or potentially insolvent company.

The two main risks in an insolvency context are wrongful trading and fraudulent trading. Directors could, in these circumstances, become personally liable for the debts of the company and may, in specific circumstances, commit a criminal offence, for which a fine or imprisonment may be applicable. Directors may also be sued personally for misfeasance.

There are also powers vested in the liquidator and the viscount of Jersey (the "Viscount") to challenge transactions entered into by a particular company at an undervalue. These are designed to combat the situation where a company gifts assets or sells assets for significantly less than their market value in the lead up to an insolvency scenario. There are specific time periods set out in the Companies Law and the Désastre Law with regard to transactions at an undervalue.

There are also powers vested in the liquidator and the Viscount to challenge a transaction which amounts to a preference. A preference is any act done by a company which has the effect of putting one of the company's creditors into a better position than that creditor would otherwise have occupied in the event of the company's insolvency. Again, there are specific time periods which apply. By way of example, a preference would arise in granting an unsecured creditor security or repaying one particular unsecured creditor in advance of other unsecured creditors.

The Royal Court is vested with wide powers to unwind transactions at an undervalue and transactions that amount to a preference or to make third parties pay a fair value for a particular benefit they might have received pursuant to a particular transaction.

To minimise the risks of incurring personal liability for wrongful trading, directors should ensure that they:

– are notified of the current financial situation of the company on a regular basis by somebody upon whose statements they are reasonably entitled to rely;
– are aware of the key factors which could, if they changed, trigger the insolvent liquidation of the company;
– are aware at the earliest possible time of any changes which may have occurred or may be about to occur in these key factors; and
– take appropriate action as soon as they become aware that there is no reasonable prospect of avoiding insolvency: for a trading company, this may mean immediately ceasing to trade although this is not necessarily the case; by way of example, where a company has an opportunity to complete a valuable contract and can do so without going further into debt.

Duty to participate in the company's affairs

Whilst the board of directors has collective responsibilities for taking major decisions and collectively directing a company's affairs, individual directors should be aware that all directors who accept office are under a positive and continuing obligation to participate in the company's affairs to some degree. The extent of the obligation will depend upon a number of factors, which could include:

– the size and activities of the company;
– the constitution of the board and the underlying management structure;
– 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.

Nevertheless, there is a minimum requirement that directors are sufficiently informed about the company's business to enable them to perform their functions. Accordingly, those becoming a director for the first time should appreciate that claiming ignorance of directors' duties and responsibilities because they are new to the job is unlikely to be an acceptable defence in the event of difficulties. Accordingly, as a general rule, directors must be clear that they have sufficient understanding of a particular area of responsibility such that they are able adequately to discharge their duties. They must make sure that they have sufficient information to be able to make informed decisions. Fundamentally, directors should not be afraid to ask for further clarification or explanation. For example, any issues with the historical accounts might be raised with the finance director or audit committee (if any) in the first instance. If in doubt, directors should take legal advice.

Relevant considerations before accepting office

Before accepting the office of director, 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 offer of a directorship. The potential liabilities of a non-executive director are just as onerous as those of executive directors, but the non-executive is unlikely to have the same ability to influence, manage or direct the company's activities and performance as his executive colleagues. A prospective director needs to be vigilant before accepting an appointment.

Conclusion

It is essential that all directors have an understanding of their duties as a matter of Jersey law. The specifics of these duties will need to be considered in light of the role given to any particular director (for example, finance director), the terms of any service contract, and the principal activities of the company itself.