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DIRECTORS IN JERSEY DUTIES, LIABILITIES AND RELIEF

WHO IS A DIRECTOR?

Directors are agents of a company, to which they owe fiduciary duties in relation to the powers granted to them. Whether formally appointed or not, under the Companies (Jersey) Law 1991 (the "Law"), a director is defined as "a person occupying the position of director, by whatever name called". This definition includes shadow directors, alternate directors, de facto directors and any other person carry out the duties of a director, and as such imposes upon them directors' duties.

WHO ARE DUTIES OWED TO?

In the first instance, assuming the company is solvent (and not nearing insolvency), directors owe their duties exclusively to the company as a whole. The benefit of these duties is not the preserve of present shareholders, as directors must balance the immediate interests of present shareholders whilst also considering those of potential future shareholders.

The position shifts once a company becomes insolvent or is nearing insolvency. In this instance, directors' duties begin to shift towards creditors, and increasingly so the worse the financial state of the company.

DUTIES

There are two legal sources of directors' duties in Jersey: the customary law duties and statutory duties. The statutory duties outlined in Article 74 of the Law complement rather than substitute the customary law obligations that directors must adhere to. In situations where there is no specific guidance from Jersey authorities regarding directors' obligations, it is probable that the Jersey courts will adopt principles from English common law. Directors are entrusted with a fiduciary role, and the Jersey courts enforce rigorous standards upon them.

CUSTOMARY LAW DUTIES

ACT WITH HONESTY AND IN GOOD FAITH

Directors must act honestly and in good faith with what the relevant director considers to be in the best interests of the company as a whole. This is subjectively assessed, and is one of the key duties codified in the Law (discussed further below).

CARRY OUT DUTIES WITHIN STATUTORY LIMITATIONS

Directors should ensure the company operates within the limitations of the Law.

ACT WITHIN CONSTITUTIONAL POWERS

As above, directors should ensure that they carry out their duties in accordance with the company's articles of association. A company's articles of association will generally outline the extent of directors' powers, as under the Law a company has unlimited capacity. Directors in breach of the company's articles of association may be held liable to account for any loss suffered by the company as a result of their breach.

EXERCISE POWERS FOR A PROPER PURPOSE

Directors are required to exercise their powers in the company's best interests and solely for the purposes for which those powers are granted. This duty applies even when there is no personal gain involved for the director, or when the director believes that using their powers for purposes other than those intended would be in the company's best interests.

NO FETTERING OF DISCRETION

As a general principle, directors should not fetter their future discretion without first obtaining consent from the company's shareholders. This duty is not necessarily applied on a strict and absolute basis, as situations may arise where directors will need to commit themselves to a course of action in order to secure the interests of the company. An example of this arises where a third party wishing to contract with the company seeks a commitment from a director.

ACCOUNTING FOR PROFITS

The fiduciary role of a director prevents them from personally profiting from any opportunities that arise from their position, notwithstanding whether their actions are honest and intended for the benefit of the company. Any profits obtained by the director through transactions involving the company or a third party, resulting from their directorship, must be accounted for to the company. This requirement applies regardless of whether it can be proven that the profit would not have been realised by the company. If the opportunity for profit arises due to a director's position, they are obligated to report and surrender it to the company.

AVOID CONFLICTS OF INTEREST

Directors must not put themselves in a position where their personal interests conflict with those of the company. The duty to avoid conflicts between personal interests and company duties is now primarily addressed by Article 75 of the Law, which sets a minimum requirement for disclosure (see further discussion below). The company's articles of association also play a role in governing this duty to some extent. In this regard however, it is important for companies to ensure that their standards for disclosure meet or exceed the minimum requirements set by the Law.

EXERCISE CARE AND SKILL

This duty has been codified by statute – see further discussion below.

STATUTORY DUTIES

ACT WITH HONESTY, CARE AND SKILL

Article 74 of the Law is the starting point for consideration of directors' duties. In exercising directors' powers and discharging their duties, Article 74(1) of the Law provides that directors must (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.

This is a subjective duty and so the Courts will not favour their own judgment over that of a relevant director's. It is up to the directors of a company to exercise their own judgement in determining how best to promote the interests of a company, and as such the burden of proof lies with a person challenging the relevant director's contention of acting in good faith.

DISCLOSURE OF INTERESTS

The duty to disclose interests is prescribed by Article 75(1) of the Law, which states a director of a company who has, directly or indirectly, an interest in a transaction entered into or proposed to be entered into by the company or by a subsidiary of the company which to a material extent conflicts or may conflict with the interests of the company and of which the director is aware, must disclose to the company the nature and extent of the director's interest.

The disclosure must be made at the first meeting of the directors at which the transaction is considered after the director concerned becomes aware of the circumstances giving rise to the duty to make it. If the director is unable to do so for any reason, the disclosure must be made as soon as is practicable after that meeting by notice in writing delivered to the secretary of the company.

LIABILITIES

The potential liabilities for directors of Jersey companies are extensive. Aside from breach of the directors' duties discussed above, the following are key considerations (particularly for private companies):

OVER-RELIANCE ON CO-DIRECTORS AND OFFICERS OF THE COMPANY

Whilst the Law permits directors to rely on and delegate functions to co-directors and other officers of the company, they must exercise caution doing so. Directors remain responsible for any delegated functions and will be liable to the company for any losses incurred when failing to exercise sufficient judgement and oversight when doing so.

Similarly, whilst directors are not necessarily expected to devote all of their time and attention to the affairs of the company, they must provide a reasonable amount to them (this will vary depending on factors such as the size of the company, number of directors and division of functions).

ACTING DURING OR NEARING INSOLVENCY

When a director possesses knowledge (or demonstrates recklessness to the fact) regarding the company's probable entry into insolvent liquidation and neglects to minimize potential losses to the company's creditors, they may be held accountable for wrongful trading. If a company is insolvent and there is evidence that its business operations were conducted with the intention to deceive creditors or for fraudulent purposes, a director who knowingly participated in the fraud may face personal or criminal liability.

DISTRIBUTIONS OF SHARES

Directors are required to produce a solvency statement in relation to any distribution. A distribution is defined as “every description of distribution of the company’s assets to its members as members, whether in cash or otherwise”. A director who makes a solvency statement without having reasonable grounds for the opinion expressed in it may be punished by up to two years imprisonment or a fine, or both.

ACTING WHILE DISQUALIFIED

If a director is disqualified by the courts and continues to act as a director (or participate in the management of the company), they will be guilty of a criminal offence and held personally liable to the company for any losses incurred during the relevant period.

RELIEF

AUTHORISATION OR RATIFICATION

The Law provides a statutory procedure under Article 74(2) allowing the members of a company to authorise or ratify a breach by a director of the duties prescribed by Article 74(1) (acting honestly and in good faith with a view to the best interests of the company, whilst exercising care and skill). It is important to note that the procedure under Article 74(2) requires all of the members of the company to authorise or ratify (as the case may be) the breach, and that following the breach the company must be able to discharge its liabilities as they fall due.

The Law also provides for the situation where not all of the members can authorise or ratify the breach because of a conflict. Members are conflicted where they are deemed to be connected to the director in question, as defined by Article 74ZA of the Law (the qualifications are extensive and beyond the scope of this note). In this situation, an ordinary or (if the articles require) special resolution may be passed by the non-conflicted members provided again that after the breach the company will be able to discharge its liabilities as they fall due.

It is important to note that the statutory authorisation or ratification procedure is unavailable if the company is no longer solvent after the breach, as at such point the interests of creditors become relevant.

COURT

Under the Law, the Royal Court may absolve a director of liability for breach of duty where it is satisfied that the director acted honestly and ought fairly to be excused. There is an equivalent provision for directors to seek relief where they have reason to believe a claim might be made, despite proceedings not yet having been commenced.

INDEMNIFICATION AND INSURANCE

Article 77 Law provides that any provision purporting to exempt a director from liability, whether in a company’s articles of association or in a contract with a company, shall be void. There are however several exceptions to this position.

Some exceptions include indemnifying directors for liabilities they may incur while successfully defending civil or criminal proceedings, or including provisions in the company’s articles of

association stating that present and former officers will be indemnified from the company's assets to the extent permitted by the Law.

The Law does not prevent a company from purchasing directors' and officers' liability insurance.

SHAREHOLDERS' LIABILITIES

UNLAWFUL DISTRIBUTIONS

As noted above, a distribution is defined, in respect of a company, as every description of distribution of the company's assets to its members as members, whether in cash or otherwise.

Article 115 of the Law provides that if a distribution (or part of a distribution) made by a company to one of its shareholders is made in contravention of Article 115, the shareholder receiving it is liable to repay it or the part of it to the company. If the distribution was made otherwise than in cash, the shareholder will be liable to pay to the company a sum equal to the value of the distribution or the part of it at that time. This is provided however that the shareholder knew (or had reasonable grounds for believing) that at the time the distribution was made, it contravened Article 115 and was not treated as having been compliant with that Article pursuant to Article 115ZA.

WRONGFUL AND FRAUDULENT TRADING

As above in relation to directors, however the key risk for shareholders is being too closely involved in the management of the company so as to be held out as a shadow or de facto director.

The Law provides at Article 181 that where a company is being wound up in a creditors' winding up and:

- (a) it has within 12 months before the commencement of the winding up made a payment under Article 55 or Article 57 or under Regulations made under Article 59 in respect of the redemption or purchase of its own shares;
- (b) the payment was not made lawfully; and
- (c) the aggregate realisable value of the company's assets and the amount paid by way of contribution to its assets (apart from this Article) is not sufficient for the payment of its liabilities and the expenses of the winding up,

the court may (on the application of the liquidator) order a person from who shares were redeemed or purchased to contribute towards the company's assets to enable the insufficiency to be met.

CONTRIBUTIONS DURING WINDING UP

Where a company is wound up, under Article 192 of the Law each present and past member of the company is liable to contribute to its assets to an amount sufficient for payment of its liabilities, the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves.

Past members of a particular class are not, as a member of that class, liable to contribute:

- (a) Unless it appears to the court that the present members of that class are unable to satisfy the contributions required to be made by them as such members;
- (b) If they ceased to be a member of that class for 12 months or more before the commencement of the winding up; or
- (c) In respect of a liability of the company contracted after they ceased to be a member of that class.

Any contribution required by members under Article 192 is limited to (a) any amount unpaid on any limited shares in respect of which they are liable, or (b) the amount undertaken to be contributed by them to the assets of the company should it be wound up.

Why choose Lexstone Lawyers?

Lexstone Lawyers is a commercially minded and pragmatic pure law firm based in Jersey, specialising in investment funds, capital markets, commercial law, banking, real estate, private wealth, financial services, employment, environment and intellectual property of all levels of complexity. Our clients include some of the most successful and reputable companies and individuals with interests in Jersey. We strive to help our clients achieve their objectives by offering a pragmatic no-nonsense approach, making us an innovative and dependable law firm you and your clients can trust. With our team of highly skilled partners we are perfectly situated to assist clients with interests in Jersey, the UK, and beyond. Our team understands the entrepreneurial mindset and we always apply this approach to the ways we work with our clients. We understand the way clients want to do business and your clients are our clients. Many of our clients are international and turned to us as trusted advisors for their offshore legal needs. We are a member of Lawyers Associated Worldwide (LAW) which gives clients access to leading international advice around the globe.

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