

GUIDE TO DIRECTORS' DUTIES IN GUERNSEY

CONTENTS

PREFACE	1
1. General Duties and Responsibilities of a Director	2
2. Other Duties under the Companies Law	3
3. Distributions, Dividends and Repurchases	3
4. Wrongful Trading	3
5. Fraudulent Trading	4
6. Preferences	4
7. Winding-Up	4
8. Indemnity of Directors	4
9. Insurance	5
10. Relief for Directors	5

PREFACE

This Guide is intended to provide a summary of the laws and procedures relating to the duties of directors of Guernsey companies.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the [contact information](#) provided at the end of this Guide.

Appleby

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1. GENERAL DUTIES AND RESPONSIBILITIES OF A DIRECTOR

All directors owe fiduciary duties to the company of which they are a director. A director owes these duties to the company alone and not to individual shareholders or to the shareholders as a group or, except in certain circumstances, to creditors of the company. A director must act in good faith, in the interests of the company. A director must exercise his powers for a proper purpose and he must keep the company's confidence.

The Companies (Guernsey) Law, 2008 (the **Companies Law**) does not attempt to codify the duties and liabilities of directors of Guernsey companies. Guernsey law applies the English common law duties of directors and the Companies Law imposes certain additional statutory duties upon directors.

1.1 Duty to Act in Good Faith

A director has a duty to act honestly and in good faith. He also has a duty to act in what he bona fide considers to be the best interests of the company as a whole. He must not act for any collateral purpose. The duty is a subjective one, and as such, a court will not substitute its own judgement for a decision or judgement which a director believes in good faith to be in the best interests of the company.

1.2 Duty to Exercise Reasonable Care and Skill

A director has a duty to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. A director is not expected to exercise a level of skill he does not have. The required level of skill and care is that which may reasonably be expected from a person of the director's knowledge and experience. Thus, the duties of non-executive directors may, in some cases, be distinguishable from those of executives with service contracts requiring the high level of skill and judgement implied by the contract.

1.3 Duty to Exercise Powers for a Proper Purpose

Even if a director is acting in good faith and in the interests of the company and its members as a whole, he must nevertheless use his powers for the purposes for which they were conferred. For example, the articles of incorporation may confer the power to issue additional shares. However, if shares were issued with the sole intention of ensuring that a director maintains personal control of the company in his capacity as a shareholder, this would clearly be in derogation of his duty to exercise his powers for a proper purpose.

1.4 Conflict of Duty and Interest

- (a) A director has a duty not to place himself in a position where there is a conflict between his duties to the company and his personal interests or duties to others.
- (b) The common law position in relation to a transaction entered into by a company in which a director is interested is qualified in a number of ways by the Companies Law and particularly by section 162 of the Companies Law.
- (c) Under the common law, a director must avoid any actual or potential conflict between his own and his company's interests. If an actual or potential conflict arises, to avoid the likelihood of liability the director must ensure that it is disclosed to, and approved by, the company.

1.5 Duty to Account for Profits

A director has a duty not to use corporate property, opportunity or information to make an unauthorised or secret profit. A director's fiduciary position precludes him from taking a personal profit from any opportunities arising from his directorship. Any profit which results from circumstances such as these must always be paid over to the company whether the profit results from a contract with the company or a third party.

2. OTHER DUTIES UNDER THE COMPANIES LAW

In addition to the duties described in section 2 above, certain provisions of the Companies Law place specific duties upon the company itself (including maintaining a register of members, directors and secretaries). As an officer of the company, a director becomes responsible for ensuring these duties are satisfied. In addition, a director of a public company may be personally liable for a breach by that company.

3. DISTRIBUTIONS, DIVIDENDS AND REPURCHASES

A company may make a distribution or authorise the payment of a dividend if the board of directors is satisfied on reasonable grounds that the company will immediately after the distribution or payment of the dividend, satisfy the solvency test.

The board of directors must approve a certificate stating:

- (a) that in their opinion the company will, immediately after the distribution or payment of the dividend, satisfy the solvency test; and
- (b) the grounds for that opinion.

The solvency test has two elements:

- (a) the company must be able to pay its debts as and when they fall due (i.e. a cash flow test); and
- (b) the company must ensure that the value of the assets is greater than its liabilities (i.e. a balance sheet test).

A company may make both on and off-market purchases of its own shares, provided that they are carried out in accordance with the Companies Law and its articles of incorporation. These requirements include obtaining shareholder consent. As the acquisition of shares by a company is deemed to be a "distribution" for the purposes of the Companies Law, the board of directors must be satisfied on reasonable grounds that the company will immediately after the distribution satisfy the solvency test and approve a certificate stating that in their opinion the company will, immediately after the purchase of its own shares, satisfy the solvency test and the grounds for that opinion.

4. WRONGFUL TRADING

A director, including a shadow director, may be guilty of "wrongful trading" if the company of which he was a director becomes insolvent and he:

- (a) knew (or ought to have concluded, based both on his actual skill, knowledge and experience and the skill, knowledge and experience which a director in his position ought to have) that there was no reasonable prospect of the company avoiding an insolvent liquidation; and
- (b) failed to take every step he ought reasonably to have taken to minimise the loss to creditors.

If convicted, a director may be ordered to contribute to the company's assets for the benefit of creditors.

Protection from liability for wrongful trading may be available, in certain circumstances:

- (a) a director must take positive action to mitigate the potential loss to creditors - merely claiming he had done nothing to cause loss will be no defence (section 434(3) of the Companies Law);
- (b) the action must be taken at the right time, i.e. when a director knew or ought to have concluded that there was no reasonable prospect of the company avoiding an insolvent liquidation. A director must neither act too late nor put the company into liquidation too early;

- (c) a director cannot avoid liability by resigning when he/she realises that the company is facing financial difficulties. Resignation is unlikely to be a means whereby a director can hope to minimise the loss to creditors; and
- (d) a director should remain on the board to ensure that his warnings are recorded, both for his own protection and so that at least one voice will be heard representing the interests of creditors, if his co-directors refuse to act. Only following such steps should resignation be considered.

5. FRAUDULENT TRADING

If, in the course of a creditors' winding-up it appears that any business of the company has been carried on with intent to defraud creditors, or for any fraudulent purpose, the court may, on the application of the liquidator, administrator, or any creditor or member of the company, declare that a director who was knowingly a party to the carrying on of the business in that manner may be liable to make such contributions to the company's assets as the court thinks proper (section 433 of the Companies Law). The director may also be criminally liable.

For example, in England the courts have held that an offence is committed when a director continues to incur credit on their company's behalf without any reasonable expectation of funds being available to repay the debt when or shortly after it falls due.

6. PREFERENCES

In certain circumstances a liquidator can apply to the court for an order to set aside transactions made by a company. A transaction can be set aside if it was either entered into at a time when the company was insolvent or the company becomes insolvent as a result i.e. unable to pay its debts within the meaning of section 407 of the Companies Law.

7. WINDING-UP

Where in the course of the winding-up of a company it appears that a director has appropriated or otherwise misapplied any of the company's assets, become personally liable for any of the company's debts or liabilities, or otherwise been guilty of any misfeasance or breach of fiduciary duty in relation to the company, the liquidator or any creditor or member of the company may apply to the court to examine the conduct of the person concerned and the court may order him:

- (a) to repay, restore or account for such money or such property;
- (b) to contribute such sum to the company's assets;
- (c) to pay interest upon such amount, at such rate and from such date;

as the court thinks fit in respect of the default, whether by way of indemnity or compensation or otherwise (section 422(3) of the Companies Law).

8. INDEMNITY OF DIRECTORS

If a director becomes liable to a third party due to an honest error on his part, there are two means by which a company may provide financial support.

Pursuant to section 157(1) of the Companies Law, any provision which purports to exempt a director of the company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void.

Furthermore, section 157(2) of the Companies Law provides that any provision by which a company directly or indirectly provides an indemnity (to any extent) for a director of the company, or an associated company, or a body corporate which is an overseas company and a subsidiary of the company, against any liability attaching to him in connection with any negligence, default, breach of

duty or breach of trust in relation to the company of which he is a director is void, except as is permitted by section 158 of the Companies Law (there is no prohibition on a company maintaining insurance against such acts) or section 159 of the Companies Law (which provides that section 157(2) of the Companies Law does not apply to qualifying third party indemnity provision).

9. **INSURANCE**

Different types of insurance are available against possible liability. Broadly, there are three categories:

- (a) directors' and officers' liability insurance, taken out by the company to protect its directors from third party claims against them;
- (b) professional indemnity insurance, which may be available to, for example, a non-executive director to cover liability incurred in the course of providing professional services to the company; and
- (c) directors' liability insurance, which may protect a director against liability to the company in his capacity as a director.

The insurance will not cover loss due to fraud or dishonesty, wilful default or criminal behaviour, although the company can take out separate fidelity insurance for its own risks on the individuals it employs.

10. **RELIEF FOR DIRECTORS**

Section 522 of the Companies Law enables the court to relieve a director of liability in an action against him if, in proceedings for negligence, default, breach of duty or breach of trust against the director of a company, it appears to the court that that the director 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 reasonably 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 or conditions as it thinks fit.

For more specific advice on directors' duties in Guernsey, we invite you to contact:

Guernsey

Jeremy Berchem

Group Partner, Group Head, Guernsey

Corporate

+44 (0)1481 755 601

jberchem@applebyglobal.com

For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found [here](#).

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