GUIDE

APPLEBY

GUIDE TO DIRECTORS' DUTIES IN JERSEY

CONTENTS

PREFACE

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

Directors are agents of the company to which they stand in a fiduciary relationship. The fiduciary relationship imposes upon directors' duties of loyalty and good faith, which are similar to those imposed upon trustees so called. As agents, directors are also under duties of care, diligence and skill. As agents, their duties are very different from the trustees' duties to be cautious and not to take risks.

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. INTRODUCTION

The nature of the legal duties owed by directors to their company depends upon the legal analysis of the relationship between directors and the company. The same may be said of the legal duties owed by directors to those dealing with the company.

The directors are agents of the company. A company can only act via agents and usually the persons by whom it acts are termed directors. The Companies (Jersey) Law, 1991 as amended (the **Law**) leaves the members free to determine how and by whom the business of the company shall be managed. In some cases the articles of a company may provide that instead of directors there should be a "council", or a "managing committee" or that the business should be carried on by managers. In private companies, it is not uncommon to provide that the business be managed by a sole "governing director". Note that the rules which apply to directors apply also to other persons, who, in substance, stand in the position of directors (see Article 1(1) of the Law).

Directors are not, as such, employees of the company or employed by the company; nor are they servants of the company, nor members of its "staff". This becomes of importance in three main instances:

- where privileges are granted by the company to employees, or servants or the staff, in particular by the granting of pensions or the right to participate in profit sharing schemes;
- when in a winding up or désastre, preferential debts are to be paid; and
- where a director wishes to claim rights under modern employment protection legislation.

A director can, however, hold a salaried employment or an office in addition to that of the directorship, which may, for these purposes, make him or her an employee or servant; and in such a case he or she would enjoy any rights given to employees as such. But the directorship and the rights through that directorship are quite separate from any rights as an employee.

The definition of director in Article 1(1) of the Law gives effect to the notion of de facto directors; thus it is not possible for a person to escape liability as a director or the duties of a director by hiding behind those who have been specifically appointed.

As stated above, directors are, in the eyes of the Law, agents of the company for which they act and the general principles of the law of principal and agent regulate in many respects the relationship between the company and its directors. This position has long been established and in *Ferguson v Wilson* (1866) LR 2 Ch 77, Cairns L J stated:

> "What is the position of directors of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable; and where the liability would attach to the principal, and the principal only, the liability is the liability of the company."

Therefore the general rule is that directors are considered to be acting as agents for the company and, as long as they make this fact clear to third parties, they should not incur any personal liability for breach of contract nor for any tortious act committed by the company. It follows that if a director fails to make it clear to a third party that he or she acts as a director of a company or, for instance, the director gives personal guarantees, then personal liability will result.

However, under Jersey law, a whole raft of statutory provisions imposes personal liability upon directors for their acts or omissions. Under Article 177 of the Law, directors may be responsible for wrongful trading of the company and under Article 178 of the Law they may be responsible for fraudulent trading. Another example is Article 30 of the Law which provides compensation for misleading statements in a prospectus.

Directors are not only agents but they are, in some sense and to some extent, trustees or in the position of trustees; but their position differs considerably from that of ordinary trustees and the strict rules applicable to such trustees do not apply in all respects to directors.

Directors are liable as trustees, but they are not trustees in the proper sense. A company is a separate legal entity and holds the legal and beneficial title to its property. However, where directors dispose of the company's property in breach of their fiduciary duties, they are treated as having committed a breach of trust, and if the director himself receives the property he will hold it upon trust for the company.

For most purposes it is sufficient to say that directors occupy a fiduciary position and all the powers entrusted to them are only exercisable in this fiduciary capacity.

2. NATURE OF THE DIRECTORS' DUTIES TO THE COMPANY

The starting point for any discussion of the duties of directors to the company is Article 74(1) of the Law which reflects, but may not be identical to, the general common law duty of directors. Article 74(1) of the Law adopts the English distinction between fiduciary duties and duties of care, diligence and skill.

Article 74(1) of the Law provides:

> "(1) 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."

2.1 Fiduciary Duties

It is worth noting that the provisions of Article 74(1) of the Law do not codify the common law position. As mentioned above, Article 74(1) of the Law broadly mirrors the common law position but there may be differences, particularly with respect to the standard of care which needs to be undertaken. However, the Jersey courts will have recourse to English case law and to local case law when considering the duties owed by directors to the company.

The test of whether the fiduciary duties of a director attached to a particular person is a functional one. Does the person in question perform the duties of a director, for example as a de facto or shadow director, even if he or she is not a director de jure? If the answer is in the positive, then the appropriate fiduciary duties will attach.

The fiduciary relationship of a director exists with a company; the director is not usually a trustee for individual shareholders. Thus a director may accept a shareholder's offer to sell shares in the company, although not having information which is available to that other, and the contract cannot be upset even if the director knew of some fact which made the offer an attractive proposition.

In certain circumstances, however, the directors may by their actions have placed themselves in a relationship with the shareholders by virtue of which they owe fiduciary duties to the shareholders as well as to the company. Thus, in *Allen v Hyatt* (1914) 30 TLR 444, the directors had secured from the shareholders options to purchase their shares through representations that this was necessary in order to effect an amalgamation with another company. The directors exercised the options and resold the shares at a profit to the amalgamating company. In the circumstances, the directors were taken to have held themselves out to the individual shareholders as acting for them on the same footing as they were acting for the company itself, that was, as agents.

The directors are under a duty to act bona fide in the best interests of the company. The company is defined in equity usually by reference to the shareholders as a whole and not by reference to the company as an entity as distinct from its members. The company does not mean the sectional interest of some (it may be a majority) of the present members, but of present and future members of the company and that on the basis that the company is to continue as a going concern. The directors should balance a long term view against the short term interest of present members.

There is now a growing body of dicta in the English courts to the effect that, when the company becomes insolvent or is nearly so, then the interests to which directors must have regard when acting in the company's interests include the creditors' interests as well as, and perhaps in some cases instead of, those of the shareholders. (An important consequence of this change in the definition of the company for the purposes of directors' duties is that directors' actions, which have adversely affected the value of the company's assets and which could have been ratified by the shareholders whilst the company was solvent, may no longer be so ratified.)

This duty is in addition to the potential liability for directors under Article 177 of the Law with respect to wrongful trading.

It should be noted that the interests of employees are not recognised in their own right as an object of the directors' concerns.

In determining whether a director has acted honestly and in good faith, the Jersey courts will follow the English courts in using a subjective rather than an objective test. It was said in *Re Smith & Fawcett Limited* [1942] All ER 542 that:

> "directors must exercise their discretion bona fide in what they consider – not what a court may consider, is in the interest of the company, and not for any collateral purposes."

In the case of *AI Airports International Limited and PI Power International Limited v Pirrwitz* [2013] JCA 177, the Jersey Court of Appeal confirmed that it is for the directors to decide what is in the company's best interest, not a court. A director should not be held to be in breach of duty, or the exercise of power held to be invalid, simply because a court subsequently concluded that it was not, in fact, in the best interests of the company.

As long as the directors have correctly informed themselves how the company is defined in law, it is left to the directors in the exercise of their business judgement to decide how the interests of the company may best be promoted. However, the court may be persuaded to infer that the director in question did not think the action was in the company's best interest where it forms the view that no reasonable director could have concluded a particular course of action to have been in the company's interest. The burden of proof in relation to good faith rests on the person challenging the directors' assertion of acting bona fide. In the absence of special provisions in the articles, the directors, when defending their decisions in court, are not confined to reasons given at the time of taking the decision, though any discrepancy may affect their credibility. However, directors may act in their own interests or that of some third party and so fail to act in the company's interests even though they act without any conscious dishonesty.

Where the company is a member of a group of companies, the question may arise whether a director must be solely concerned with the interests of his own company or whether he may take into account the benefit of the group as a whole. In *Charterbridge Corp v Lloyds Bank Ltd*, the English courts said that a director must not be guided by the group interests as a whole if this might be detrimental to his own company's interest, particularly if the company has separate creditors. If, however, the intended measure does not conflict with the interests of his company, it is not a breach of duty to his own company that he is taking into account the benefits of the group as a whole. A director cannot be compelled to take into account the interests of the group of companies.

The directors must exercise their powers for a proper purpose. In the *Pirrwitz* case, the Court of Appeal confirmed this is an objective duty (so a director can be in breach notwithstanding his honest belief that what was done was in the company's best interest). Where directors have a discretion and are, bona fide, acting in the exercise of it, the courts will not interfere with their acts unless the particular purpose for which the discretion is being exercised is not one of the purposes for which it is conferred. In several cases the English courts have considered the directors' powers to issue shares: it has been held that directors are not entitled to use their power of issuing shares mainly to maintain their control or that of themselves and their friends over the company's affairs, nor merely to defeat the wishes of the existing majority of shareholders.

It may be that the directors act for more than one purpose, some of the purposes being proper and others improper. In various Commonwealth jurisdictions it has been held that the power was validly exercised if the primary purpose for which it was exercised was a proper one.

Like other fiduciaries, directors must not to put themselves in a position of conflict (actual or potential) between their personal interests and their duties to the company or between their duty to the company and the duty owed to another person.

Under English common law, a director's powers of contracting with his company are extremely limited, unless the articles of the company expressly permit the director so to contract. He may take up shares or debentures, including convertible debentures, of the company, though he cannot vote in respect of allotments to himself and he may buy the right to subscribe for shares or debentures. In other respects he is, like a trustee, disqualified from contracting with the company and for a good reason; the company is entitled to the collective wisdom of its directors and if any director is interested in the contract, his interest may conflict with his duty, and the law always strives to prevent such a conflict from arising. The director may enter into a contract only if he makes full disclosure of all material facts to the members of the company, who then approve the contract. Even if it can be shown that the contract in question is fair, the director cannot be allowed to enter into it, for the English courts will not, in such cases, look into the merits, but adhere strictly to the rule that the possible conflict of interest and duty must not be allowed to rise.

These are the ordinary equitable rules applicable to transactions in which the directors may have an interest, but a company may waive the benefit of such rules and allow a director to make a contract, or to be interested in a contract, with a company, and modern articles very commonly make some provision accordingly.

Under English common law, the company is at liberty to waive completely the rules protecting it as principal in dealings in which directors have an interest. However, Articles 74A and 75 of the Law restrict this position. Article 74A of the Law relates to contracts with a sole member who is also a director. The terms of such a contract must be set out in writing or recorded in the minutes of the first meeting of directors of the company following the contract. Article 75 of the Law prescribes the duty of directors to disclose interests.

Under English statute, there are further requirements. There are substantive restrictions on directors' freedom to contract with their companies, which may take the form either of prohibitions on certain types of contracts or require the contract to be submitted to the approval of a general meeting. With respect to directors' service contracts, English statute requires the company in general meeting to approve a term whereby the director's employment with the company continues for a period exceeding five years.

Loans to directors' companies, and those in accordance with whose directions or instructions the directors of the company are accustomed to act (shadow directors), are also prohibited, as are a range of analogous transactions.

Payments of compensation for loss of office must be approved in advance by the company in general meeting under Section 217 of the UK's Companies Act 2006. When a director acquires from or transfers to his company non-cash assets of a certain size, the transaction requires either prior approval or subsequent affirmation within a reasonable period by the company in general meeting; otherwise it is voidable at the option of the company.

Under Section 40 of the Companies Act 2006, a contract between a director and his company is voidable if, in entering into the contract, the board of directors of the company have exceeded any limitation of their powers contained in the company's constitution. Although there is no statutory provision in the Law, this is the position at Jersey common law (see *Re Zaki Ltd* (1987-88) JLR).

A logical extension of the principle that a director must act in the company's best interests requires a director not to contract with other directors or with third parties in such a way as to fetter his future discretion, although there is little judicial authority on the point.

The no conflict rule might also be thought to prohibit a person from being a director of competing companies, but it is not clear whether in fact this is the position.

The maxim "*delegatus non potest delegare*" applies to directors, so that prima facie they cannot delegate their powers; but this rule may be altered by giving directors express or implied authority to delegate. Usually the articles expressly provide for directors to appoint servants and agents and determine their duties and powers, and further that directors may delegate to any one or more of themselves any of their powers.

A company director may not make a secret profit for himself from the use of corporate assets, information or opportunities. This principle, which has its origins in the no conflict rule, has probably now attained status of a separate rule.

2.2 **Duties of Care, Diligence and Skill**

Where an agent professes a trade or profession, he is required to display such care, diligence and skill as would a reasonably competent member of the trade or profession. However, other agents are required to exercise only such skill as they possess and such care and diligence as would be displayed by a reasonable person in the circumstances. This reflects the wording of Article 74(1)(b) of the Law. This corresponds with the tendency of the English courts to assimilate the duties required of the director to those of the non-professional agent.

The remarks of Romer J. in *City Equitable Fire Insurance Co Limited, Re (No 7)* is considered in England to be the definitive case. It can be analysed under a series of headings:

(a) **Directors are not Expected to be Experts unless Appointed as such**

A director is not expected to exercise a skill which he does not possess. Romer J said that:

> "a director of the life insurance company, for instance, does not guarantee that he has the skill of an actuary or of a physician."

It is clear from these remarks that directors of a specific company are not required to be experts in the type of business which the company promotes unless they are appointed because of their specialist qualifications. Many boards consist only partly of such experts and, for the rest, of persons who are specialists in business administration or in certain general aspects of business management such as legal, financial, accounting, banking or expert trade practice. Upon these principles a director would be entitled to rely upon the advice of his fellow directors and in matters in which they are, or should be, experts.

A number of English cases have accepted the distinction between the duty to be skilful, on the one hand, and to take care on the other; the first being defined by reference to the particular director's skill and experience, and the latter by reference to the standard to be expected of the ordinary man. Perhaps there is a difference here with the Jersey formulation whereby the care, diligence and skill to be expected is that of a reasonably prudent person. But some English authorities, in relation to both skill and care, the director is held to an objective standard (that of a reasonable person in the position of the director), though that standard would be increased if the director's subjective abilities and skills are able to meet a higher standard than that of the reasonable director.

Whatever the position in Jersey, a claimant needs to show that the lack of skill or care caused the loss for which a complaint is made. In particular, where the allegation is that the defendant failed to take steps he ought to have taken, it needs to be established that, if the proposed steps had been taken, the loss would not have occurred.

(b) **A Director Must Exercise Reasonable Care and Diligence but is not Liable for Errors of Judgement**

The Jersey position would appear to mirror English common law. Where a director takes part in the company's business, he must display reasonable care. Such reasonable care must be measured by the care that an ordinary man might be expected to take in the same circumstances on his own behalf. He is not responsible for damages occasioned by any errors of judgement. From this it falls that in appropriate circumstances the director may rely upon an opinion of an outsider. Of course the obtaining of outside advice does not absolve directors from the duty of exercising their judgement upon such advice. Directors may be considered negligent if they proceed to a decision without first obtaining expert advice in certain circumstances. Such an outsider must appear to be qualified to give such advice.

The City Equitable Fire Insurance case was recently considered in the Cayman Islands Court of Appeal decision in the case of *Weavering v Peterson & Ekstrom*.

The Cayman Islands Court of Appeal considered in some detail the first limb of the test in *Re City Equitable Fire Insurance* and concluded that:

(i) in order to establish wilful neglect or default it is necessary (at least under the first limb of Romer J's test) for the company to prove to the satisfaction of the court that the director made a deliberate and conscious decision to act or to fail to act in knowing breach of his duty: negligence, however gross, is not enough. The Cayman Islands Court of Appeal held that there was, in fact, no specific evidence of either director having made a deliberate and conscious decision not to read a relevant report with sufficient care knowing that failure to do so was in breach of his duty.

(ii) to establish whether a director was being recklessly careless in the sense of not caring whether his act or omission is or is not a breach of duty), the Cayman Islands Court of Appeal held that it is necessary to satisfy the court that the director appreciated (at the least) that his or her conduct might be a breach of duty and made a conscious decision that, nevertheless, he or she would do (or omit to do) the act complained of without regard to the consequences; and if the evidence does not establish that the defendant at least suspected that his conduct might constitute a breach of duty, it is not appropriate to characterise his breach of duty as "wilful neglect or default".

Since there was no support in the evidence of the *Weavering v Peterson & Estrom* case for the contention that the two directors had the requisite conscious appreciation that they might be breaching their duty to read the reports to the board with sufficient care to discover that the counterparty to trades was a related party, the claim against them failed and their appeal was allowed.

(c) **A Director May Reasonably Rely on Co-directors and Officers of the Company**

When determining duties we must look to the nature of the company's business, and, provided the work is distributed in a reasonable way, to the manner in which the work is distributed between the directors themselves and the other officials in the company. As Romer J said:

> "in respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."

In determining whether a director has been guilty of negligence, the court will take into account the character of the business, the number of directors, the provisions of the articles, the ordinary course of management and practice of directors, the extent of their knowledge and experience, and all the special circumstances. Of course the reliance of the director upon his co-directors and the officers should not be unquestioning. Even non-executive directors, when delegating responsibility to management, are under a duty to ensure that sufficient controls are in place to ensure that abuses can be quickly identified and the board is always in a position to guide and monitor the management.

This point is extremely important as in large companies the board cannot in fact manage the company. Extensive delegation to particular executive directors, to senior managers who are not directors, and to senior employees of the company is inevitable in a large business organisation.

It should be noted, however, that it has been held that the director who signs a cheque cannot claim that he did so as a mere ministerial act and that if he neglects enquiry, trusting in his co-directors or one of the company's officers, he will be himself liable to the company if the cheque is not authorised by the board or if it was an improper payment.

It is difficult to lay down hard and fast rules concerning the delegation of responsibility. In the words of Lord MacNaghten in *Dovey v Cory* [1901] AC 477, 488:

> "I do not think it desirable for any tribunal to do that which Parliament has abstained from doing – that is, to formulate precise rules for the guidance or embarrassment of businessmen in the conduct of business affairs. There never has been, and I think there never will be, much difficulty in dealing with any particular case on its own facts and circumstances; and, speaking for myself, I rather doubt the wisdom of attempting to do more."

The overriding duties are for the director to act honestly and reasonably, but there are specific rules which can be deduced from the decisions of the English courts.

- It is the duty of each director to see that the company's monies are from time to time in a proper state of investment, except insofar as the company's articles of association may justify him in delegating that duty to others, and that the company's assets are being dealt with; with the due authority of the company acting by its board of directors.
- When presenting their annual report and balance sheet, directors ought not to be satisfied as to the value of their company's assets merely by the assurances of their chairman, nor with the expression of belief of the auditor.
- A list of cheques to be authorised by the board should be presented at each board meeting showing the amounts and the name of the payee. This practice will preclude the risk of the managing director obtaining the signature of different co-directors to cheques for the same purpose.

- The company's securities should be kept in a safe place.

A director must give a reasonable amount of attention to the company's affairs. The amount of time to be given will depend largely upon the extent to which devolution of duties has been organised, and upon the number of directors.

It is not necessary for a director to attend every board meeting unless the articles specify this; but he ought to attend whenever he is reasonably able to do so and continuous non-attendance of meetings may render the director guilty of the breaches of trust which are committed by others. It is not part of the duty of a director to take part in every transaction which is considered at a board meeting. It should be pointed out that even where a director has been shown to be negligent as a result of non-attendance of board meetings; it may nevertheless be very difficult to demonstrate that any particular loss has occurred to the company as a result of the non-attendance.

In summary, while the failure to attend board meetings with reasonable regularity is a breach of a director's duty, it depends on the surrounding circumstances and it is a question of fact what is to be understood by "reasonable regularity". Generally speaking, the fewer the directors, the greater the duty to attend. The duty of the director is not as strict as that of a trustee. A trustee is liable if he allows trust funds, or the control of such funds, to remain for an unreasonable period in the hands of his co-trustee or co-trustees and loss arises therefrom. However, a director may rely upon co-directors or officers of the company provided that such reliance is reasonable in the circumstances.

Directors must be diligent and the non-performance of some act which it was their duty to perform may amount to a breach of duty. The burden of proving negligence rests on the claimant. Directors have a large discretion, and while acting honestly within it, cannot be charged with breach of duty. As stated above, mere errors of judgement and imprudence on the part of directors do not constitute either negligence or breach of duty.

The principles served above were developed by the English courts largely in relation to non-executive directors, but it is common today for a proportion of the members of the board to hold full time service agreements with a company. An employment contract may impose obligations upon a director which go beyond his duties as a director. For skilled employees, the failure to afford the requisite skill which has been expressly and priorly promised is a breach of the legal duty.

2.3 Specific Statutory Duties

In addition to the duties specified under Article 74(1) of the Law and the common law duties discussed above, the Law sets down certain specific duties on directors.

(a) Duty to Disclose Interests

The director has a duty to disclose all material conflicts as soon as practicable, this mirrors the common law fiduciary duty imposed on directors.

Article 75 of the Law provides as follows:

> "(1) 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, shall disclose to the company the nature and extent of the director's interest.
>
> (2) The disclosure shall be made:

a) 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 his or her duty to make it; or

b) if for any reason the director fails to comply with sub-paragraph (a), as soon as practical after that meeting, by notice in writing delivered to the secretary.

(2A) The secretary, where the disclosure is made to him or her:

a) shall inform the directors that it has been made; and

b) shall in any event table the notice of the disclosure at the next meeting of the directors after it is made.

(2B) Any disclosure at a meeting of the directors shall be recorded in the minutes of the meeting.

(3) A disclosure to the company by a director in accordance with paragraph (2) that he or she is to be regarded as interested in a transaction with a specific person is sufficient disclosure of his or her interest in any such transaction entered into after the disclosure is made.

(4) Nothing in this Article prejudices the operation of any rule of law restricting directors of a company from having an interest in transactions with a company."

(b) **Responsibility for Wrongful Trading**

A director has a duty not to allow the company to trade if he knows (or is reckless as to whether) the company will not avoid insolvency. The provisions relating to wrongful trading are contained both in Article 177 of the Law and Article 44 of the Bankruptcy (*Désastre*) (Jersey) Law 1990. Article 177 of the Law is as follows:

"(1) Subject to paragraph (3), if in the course of a creditors' winding up it appears that paragraph (2) applies in relation to a person who is or has been a director of the company, the court on the application of the liquidator may, if it thinks it proper to do so, order that that person be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company arising after the time referred to in paragraph (2).

(2) This paragraph applies in relation to a person if at a time before the date of commencement of the creditors' winding up of the company that person as a director of the company:

a) knew that there was no reasonable prospect that the company would avoid a creditors' winding up or the making of a declaration under the Désastre Law; or

b) on the facts known to him or her was reckless as to whether the company would avoid such a winding-up or the making of such a declaration.

(3) The court shall not make an order under paragraph (1) with respect to a person if it is satisfied that after either condition specified in paragraph (2) was first satisfied in relation to him or her the person took reasonable steps with a view to minimising the potential loss to the company's creditors.

(4) On the hearing of an application under this Article, the liquidator may himself or herself give evidence or call witnesses."

These provisions create liability where there is no fraud, but where the conduct of the director is unreasonable and has caused loss. Again, these provisions mirror the emerging common law duty of the director towards creditors where the company is insolvent. A director will be excused if he took reasonable steps to minimise the potential loss to creditors. Accordingly, as soon as a director becomes aware that the company is insolvent or cannot avoid it, then he must take all reasonable steps to protect the creditors' position. If the company does trade wrongfully, the director could be personally liable for contribution to the assets of the company as the court thinks proper. However, this liability is limited to unpaid debts and liabilities.

The provisions under the UK's Insolvency Act 1986 are similar. A director is liable if he knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvency. However, he is only excused if he took every step that he ought to have taken to minimise the loss. Therefore the obligations of a director under UK legislation appear more stringent than in Jersey.

(c) **Responsibility for Fraudulent Trading**

A director or any other person may also be liable for fraudulent trading. Article 178 of the Law is as follows:

"(1) 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 of the company or creditors of another person, or for a fraudulent purpose, the court may, on the application of the liquidator, order that persons who were knowingly parties to the carrying on of the business in that manner are to be liable to make such contributions to the company's assets as the court thinks proper.

(2) On the hearing of the application the liquidator may himself or herself give evidence or call witnesses.

(3) Where the court makes an order under this Article or Article 177, it may give such further directions as it thinks proper for giving effect to the order.

(4) Where the court makes an order under this Article or Article 177 in relation to a person who is a creditor of the company, it may direct that the whole or part of a debt owed by the company to that person and any interest thereon shall rank in priority after all other debts owed by the company and after any interest on those debts.

(5) This Article and Article 177 have effect notwithstanding that the person concerned may be criminally liable in respect of matters on the ground of which the order under paragraph (1) is to be made."

The director guilty of fraudulent trading may be held liable for the debts of the company incurred whilst fraudulently trading. There is also criminal sanction. It should be noted that it is notoriously difficult to prove intent to defraud another person. Once wrongdoing is established liability is unlimited and the court has complete discretion to make any order in regard to liabilities as it sees fit.

(d) **Compensation for Misleading Statements in Prospectus**

A director has a duty under Articles 30 of the Law not to circulate prospectuses containing untrue or misleading information unless he reasonably believes otherwise.

"**Article 30 Compensation for misleading statements in prospectus**

(1) A person who acquires or agrees to acquire a security to which a prospectus relates and suffers a loss in respect of the security as a result of the inclusion in the prospectus of a statement of a material fact which is untrue or misleading, or the omission from it of the statement of a material fact, shall, subject to Article 31, be entitled to compensation:

a) in the case of securities offered for subscription, from the body corporate issuing the securities and from each person who was a director of it when the prospectus was circulated;

b) In the case of securities offered otherwise than for subscription, from the person making the offer and, where that person is a body corporate, from each person who was a director of it when the prospectus was circulated;

c) from each person who is stated in the prospectus as accepting responsibility for the prospectus, or any part of it, but, in that case, only in respect of a statement made in or omitted from that part; and

d) from each person who has authorized the contents of, or any part of, the prospectus.

(2) Nothing in this Article shall make a person responsible by reason only of giving advice as to the contents of a prospectus in a professional capacity.

(3) This Article does not affect any liability which any person may incur apart from this Article.

(4) This Article applies only to a prospectus first circulated after the Article comes into force.

Article 31 Exemption from liability to pay compensation

A person shall not be liable under Article 30 if the person satisfies the court –

a) that the prospectus was circulated without the person's consent;

b) that, having made such enquiries (if any) as were reasonable, from the circulation of the prospectus until the securities were acquired, the person reasonably believed that the statement was true and not misleading or that the matter omitted was properly omitted;

c) that, after the circulation of the prospectus and before the securities were acquired the person, on becoming aware of the untrue or misleading statement or of the omission of the statement of a material fact, took reasonable steps to secure that a correction was brought to the notice of persons likely to acquire the securities;

d) in the case of a loss caused by a statement purporting to be made by a person whose qualifications give authority to a statement made by the person which was included in the prospectus with the person's consent, that when the prospectus was circulated the person reasonably believed that the person purporting to make the statement was competent to do so and had consented to its inclusion in the prospectus; or

e) that the person suffering the loss acquired or agreed to acquire the securities knowing that the statement was untrue or misleading or that the matter in question was omitted."

These provisions allow personal liability to attach to the director as well as to the company if the director knowingly or recklessly makes a statement, which is misleading, false or deceptive, to induce a person to acquire or dispose of securities. This is in addition to the potential criminal liability contained in Article 33 of the Law. However, a director can be exempt from liability for misleading statements contained in a prospectus under Article 31 of the Law if:

- the prospectus was circulated without his or her consent;
- he or she made reasonable enquiries to ensure and believed that the statements were true and not misleading or were properly omitted;
- he or she took reasonable steps on becoming aware of the offending statements to ensure a correction was brought to the notice of persons likely to purchase the securities;
- he or she reasonably believed that those making the offending statements were competent to do so and had consented to their inclusion in the prospectus; or
- the third party knew that the offending statement was untrue and nevertheless agreed to purchase the securities.

Directors should also be aware of their potential liability to compensation for false or misleading prospectuses as contained in Articles 5 and 6 of the Collective Investment Funds (Unclassified Funds) Prospectuses (Jersey) Order 1995 and Article 7 of the Collective Investment Funds (Certified Funds – Prospectuses) (Jersey) Order 2012. These relate to prospectuses issued by open-ended investment companies and certified funds respectively.

(e) **Insider Dealing**

Under Part 3A of the Financial Services (Jersey) Law 1998 as amended, a director has a duty not to deal on his own account on securities of the company if he has information by virtue of his possession relating to those securities. A breach of this Article incurs criminal liability.

(f) **Directors' Disqualification**

Article 78 of the Law provides powers for the disqualification of directors. Under Article 79 the person who acts in contravention of an order made under Article 78 is personally responsible for such liabilities of the company or of a body corporate as are incurred at the time when that person was, in contravention of the order, involved in its management.

3. APPLICATION TO THE COURT FOR RELIEF AND RATIFICATION

3.1 Relief to Directors in Certain Circumstances

Article 212 of the Law provides relief for directors in certain circumstances:

"(1) 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 the person has acted honestly and that having regard to all the circumstances of the case (including those connected with his or her appointment) he or she ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the court may relieve the person, either wholly or partly, from his or her liability on such terms as it thinks fit.

(2) If an officer or person mentioned in paragraph (1) has reason to apprehend that a claim will or might be made against the person in respect of negligence, default, breach of duty or breach of trust, he or she may apply to the court for relief; and the court on the application has the same power to relieve the person as it would have had if proceedings against him or her for negligence, default, breach of duty or breach of trust had been brought."

Such an application to the court does not rectify a breach of duty. It does allow the court, having regard to all the circumstances of the case, to absolve the director from liability if it is satisfied that:

- he or she has acted honestly; and
- he or she ought fairly to be excused.

The director does not have to wait for proceedings to be brought against him or her for breach of duty but may apply for relief in anticipation of such a claim being brought.

3.2 Ratification for Breach of Directors' Duties

Article 74(2) of the Law provides for ratification of breach of directors' duties:

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

a) all of the members of the company authorize or ratify the act or omission; and

b) after the act or omission the company will be able to discharge its liabilities as they fall due."

All members must ratify the conduct if the director is to be excused under this Article.

Further, in order to follow the provisions of the UK Companies Act 2006, the Law was recently amended to provide at Article 74(3) as follows:

"(3) Furthermore, no act or omission of a director shall be treated as a breach of paragraph (1) if –

(a) a resolution, or (if the articles so require) special resolution, authorizing or ratifying the act or omission is passed otherwise than by all of the members of the company and in accordance with paragraphs (4) and (5); and

(b) after the act or omission the company will be able to discharge its liabilities as they fall due.

(4) Where the resolution authorizing or ratifying the act or omission is proposed as a written resolution, neither the director (if a member of the company) nor any member connected with the director shall be treated for the purposes of Article 95(1B) and (1C) as a member entitled to vote on the resolution.

(5) Where the resolution authorizing or ratifying the act or omission is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favour of the resolution by the director (if a member of the company) and any member connected with him; but this does not prevent the director or

> any such member from attending, being counted towards the quorum or taking part in the proceedings at any meeting at which the decision is considered."

This amendment preserves the provisions of Article 74(2) and the ability of a company to ratify a breach of duty by a director with the unanimous consent of all shareholders entitled to vote (*Re Duomatic Ltd 1969*) but puts in place greater safeguards where there is not unanimity to ensure that the director and members connected to the director are not entitled to vote to ratify such director's acts, with a definition of "connected" included in the Law.

In addition the company must not be insolvent. Illegal acts (*re Exchange Banking Co* [1882] 21 Ch. D 519) will not be capable of being ratified under this article and the transaction in question will be capable of being set aside. There is some doubt as to whether the same may be true of acts involving lack of bona fides on the part of the director (*Mason* v *Harris* [1879] 11 Ch D 97). Likewise, conduct that amounts to fraud on the minority such as misappropriation of company property cannot be ratified (*Cook* v *Deeks* [1916] 1 AC 554).

Articles 74, 77 (see paragraph 5) and 212 of the Law are limited in their application and should not be relied on as a way of escaping liability. Breaches should be avoided by the director in the first place by acting in accordance with his duties, for example, obtaining advice from professional advisers where necessary, preserving evidence, keeping accurate legible records and ensuring there is a formal record made of the director's position.

4. INDEMNIFICATION

Prior to 30 March 1992, a director could be absolved of personal liability in the articles of association provided that he had not acted dishonestly. In *Viscount v Shelton* [1986] 1 WLR an indemnity in the articles against all losses incurred by a director in the conduct of the company's business was valid even though the act in question was *ultra vires*.

However, for breaches that take place after 30 March 1992, Article 77 of the Law provides that any provision, whether contained in the articles or in a contract, purporting to exempt a director from liability shall be void except in specified circumstances.

Article 77 of the Law provides:

"(1) Subject to paragraphs (2) and (3), any provision, whether contained in the articles of, or in a contract with, a company or otherwise, whereby the company or any of its subsidiaries or any other person, for some benefit conferred or detriment suffered directly or indirectly by the company, agrees to exempt any person from, or indemnify any person against, any liability which by law would otherwise attach to the person by reason of the fact that the person is or was an officer of the company shall be void.

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

a) any liabilities incurred in defending any proceedings (whether civil or criminal) –

i. in which judgment is given in the person's favour or the person is acquitted,

ii. which are discontinued otherwise than for some benefit conferred by the person or on the person's behalf or some detriment suffered by the person, or

iii. 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), the person was substantially successful on the merits in the person's resistance to the proceedings;

b) any liability incurred otherwise than to the company if the person acted in good faith with a view to the best interests of the company;

c) any liability incurred in connection with an application made under Article 212 in which relief is granted to the person by the court; or

d) any liability against which the company normally maintains insurance for persons other than directors.

(3) Nothing in this Article shall deprive a person of any exemption or indemnity to which the person was lawfully entitled in respect of anything done or omitted by the person before the coming into force of this Article.

(4) This Article does not prevent a company from purchasing and maintaining for any such officer insurance against any such liability."

It would appear that if the indemnity falls foul of Article 77 of the Law the whole of the indemnity is void.

Paragraph (1) of Article 77 of the Law is intended to catch indemnities given either directly or indirectly by the company. It would appear that indemnities given by holding companies or beneficial owners of companies are not caught by the provisions, unless they indirectly amount to an indemnity by the company; for instance where there are back to back indemnities.

It should be noted that a director has no direct contractual nexus with the articles of association and may not therefore be able to enforce directly an indemnity in his favour. In *Globalink Telecommunications Ltd* v *Wilmbury Ltd*, Burnton J held that a company's articles of association were not automatically binding as between the company and its officers but could expressly or impliedly be incorporated into a contract between the company and a director ([2003] 1 BCLC 145).

To mitigate the risk of not being able to enforce an indemnity in the company's articles, directors are therefore increasingly seeking the protection of stand-alone indemnities.

5. REMOVAL OF DIRECTORS

There are significant differences under UK and Jersey Law with respect to the removal of directors. Section 168 of the UK's Companies Act 2006 provides that a company by ordinary resolution given at a meeting and requiring special notice, may remove a director before the expiration of his office, notwithstanding any agreement between the company and himself. Section 168 is a cardinal principle of UK company law. While the shareholders have no power, apart from that given to them by statute or articles, to intervene in the management of the company's affairs, this section was designed to enable them to control the directors by removing them. In practice, the power given by articles to the members does not amount to much. Under English and Jersey law the balance of power is normally with the directors who, by the articles, are usually authorised to exercise the general powers of the company, and interference with the managerial activities of the directors is not encouraged by statute and not normally by articles. Section 168 enables the shareholders to assert themselves against the directors and makes it clear that the ultimate control is in the hands of the proprietors of the company.

There is no similar provision in the Law, however Article 72(e) of the Companies (Standard Table) (Jersey) Order 1992 as amended enables the company by ordinary resolution to remove the director.

Articles also often provide for the office of director to be vacated if he is requested in writing by all his co-directors to resign. The power to remove given to the board by such an article is a fiduciary one, but a notice complying with the terms of the articles has immediate effect and the director sought to be expelled will not remain a director, even if one or more of the requesting directors did not act bona fide in the best interests of the company.

Weighted voting rights of the shares held by a shareholder director in the case of his threatened removal from office as director are permissible.

The removal of a director of the company by his fellow directors does not thereby deprive him of any claim for compensation for damages which he might have. Directors who are employed under a contract of services may also have rights under Jersey employment legislation. The impact of the Employment (Jersey) Law 2003 is particularly significant in this regard.

In the case of a small private company founded on the personal relationship between their members (sometimes known as **quasi-partnerships**), the exercise of the right to remove a director by ordinary resolution, may constitute a breach of good faith which the members owe to each other and it may be inequitable to remove a director in such circumstances. In such a case the courts have power to order the winding up of the company under Article 155 of the Law on just and equitable grounds. Removal of a director in such circumstances may also amount to unfairly prejudicial treatment, giving rise to a remedy under Part 20 of the Law relating to unfair prejudice.

It is worth noting that the English courts very rarely enforce specifically a contract of service either at the instance of an employer or employee.

6. LIABILITY OF DIRECTORS TO OUTSIDERS

6.1 Contractual Liability

Directors, being agents, are not liable on contracts purporting to bind their company.

If directors make a contract on behalf of the company, only the company is liable. If they have no authority to make the contract, they are still not personally liable on the contract, although they may be liable in damages for breach of an implied warranty of authority if they can be deemed to have warranted that they had authority to act on behalf of the company. The directors who have duly acted on behalf of the company are not personally liable to the contracting party even if the company's failure to carry out the contract is due to the fault of the directors, or if the company could not, at the time the contract was made, fulfil it.

The directors of the company may, of course, contract to make themselves personally liable to third parties.

6.2 Statutory Liability

In a number of cases legislation now provides that directors who are in default shall be personally liable to persons without the company. Such liability may arise: on a misstatement or omission in the prospectus; by order of the court on the winding up of the company, under the fraudulent trading and wrongful trading provisions; or where a person acts in breach of a disqualification order.

Where a company is dissolved under a summary winding up and the assets of the company are not sufficient for the discharge of the liabilities of the company, any director or liquidator who signs a statement of solvency under Articles 146 or 150 of the Law may be liable to contribute to any insufficiency in the company's assets. The director has a defence if he can show that he had reasonable grounds for being satisfied when he signed the statement that the company had no liabilities.

In theory, the memorandum of association of a company limited by shares (or by guarantee) may provide that the liability of its directors shall be unlimited. In practice, such clauses are not used.

6.3 **Tortious Liability**

There are two situations to be distinguished with regard to liability for torts. The first is where a tort is committed by the company through one of its servants or officers and the question is whether a director, although not the officer in question, is liable for the tort committed by the company. The second is where the director is the person whose acts have caused the company to be liable in tort and the question is whether the plaintiff can sue the director personally.

Where the tort is committed by the company, a director does not make himself liable merely because of the fact of his directorship. Nevertheless, a director who, whilst not committing a tort himself, has authorised, directed and procured the commission of a tort by his company may be personally liable to the victim of the tort even though he was not aware that the acts he authorised were tortious or did not care whether the acts were tortious or not. Whether a director has authorised a tort will depend on the facts of each case.

Equally a director is not held responsible for the fraud of his co-directors, unless he has expressly or impliedly authorised it.

Where it is the acts of the director in question which give rise to the liability of the company, there are two competing approaches to the issue of the personal liability of the director. One approach is to say that the principles applicable are exactly the same as in the cases where the principal is not a company and the agent is not a director. The normal rules of agency would apply and a director acting as agent who commits a tort in the course of his functions as a director is always personally liable and the company will be liable as well on the basis of the doctrine of vicarious liability. The alternative approach, which the English and Commonwealth courts appear to lean towards, proceeds from the premise that the separate legal personality of the company requires directors to be to some degree shielded from liability which would otherwise apply to them in the same way that the doctrine of limited liability protects the shareholders. On this approach, the director is not made personally liable unless he has made it clear to the third party that he has assumed personal responsibility as opposed to assuming responsibility on behalf of the company.

7. **CONCLUSION**

Directors of companies must be fully aware of their powers and duties so that they can avoid personal liability to the company and third parties. In addition to their duties under common law and the statutory regime in Jersey, directors must have regard to the company's memorandum and articles, shareholder resolutions and board minutes. The company's constitutional documents and any contract for services or contract of employment are in fact the starting point in determining directors' responsibilities.

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

Jersey
Wendy Benjamin
Partner, Group Head, Jersey
Corporate
+44 (0)1534 818 057
wbenjamin@applebyglobal.com

Andrew Weaver
Partner
Corporate
+44 (0)1534 818 230
aweaver@applebyglobal.com

James Gaudin
Partner
Corporate
+44 (0)1534 818 337
jgaudin@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.