

Distributions by Jersey companies

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What is a distribution?

Article 114(1) of the Companies (Jersey) Law 1991, as amended, (the **Law**) defines a distribution, in relation to a company, as “every description of distribution of the company’s assets to its members as members, whether in cash or otherwise.”

Article 114(2) of the Law states that a distribution does not include:

- an issue of shares as fully or partly paid bonus shares
- the redemption or purchase of any of the company’s own shares
- any reduction of share capital by extinguishing or reducing the liability of any of the members on any of the company’s shares in respect of capital not paid up
- a distribution of assets to members of the company on its winding up.

Article 115(2) of the Law makes it clear that the Law only restricts or seeks to control distributions which reduce the net assets of a company and in respect of which provision would have to be made in the accounts of the company under the GAAP adopted by the company (Article 115(2A)). Therefore, this would not catch guarantees given to support parent entities unless the directors believed that the guarantee would be called upon and this was reflected in the accounts.

Funding a distribution

A Jersey company may make a distribution from any source (other than nominal capital account and capital redemption reserve). In particular, a distribution can be made from a share premium account (for a par value company) or a stated capital account (for a no par value company) and in either case from a profit and loss account, even where a company has

accumulated losses.

Distribution Procedure

A Jersey company can make a distribution at any time, but:

- where the company is an open-ended investment company, the directors who are to authorise the distribution must reasonably believe that immediately after the distribution has been made the company will be able to discharge its liabilities as they fall due; and
- where the company is not an open-ended investment company, the directors who are to authorise the distribution must make a statement (**Solvency Statement**) that they have formed the opinion:
 1. that, immediately following the date on which the distribution is proposed to be made, the company will be able to discharge its liabilities as they fall due; and
 2. that, having regard to (i) the prospects of the company and to the intentions of the directors with respect to the management of the company's business; and (ii) the amount and character of the financial resources that will in their view be available to the company, the company will be able to continue to carry on its business and discharge its liabilities as they fall due until the expiry of the period of 12 months immediately following the date on which the distribution is proposed to be made or until the company is dissolved under article 150 of the Law (that is, on the basis of a solvent winding up).

The above is referred to in this briefing as the **Distribution Procedure**.

A Solvency Statement is required even where the Jersey company has distributable reserves.

The Solvency Statement could be made orally by a director at a board meeting, and evidenced in board minutes, but we recommend that a separate written statement is made and signed by the relevant directors.

Articles of Association

In some instances, the articles of association of the Company will impose restrictions, preferences or procedural requirements on the making of distributions and they should therefore be reviewed in all cases. In particular, the articles of association of most companies incorporated prior to the changes to the distribution regime will permit directors to pay interim dividends only if it appears to them that they are justified by the profits of the company available for distribution.

Ratification of an unlawful distribution

The statutory requirement that the solvency statement under the Distribution Procedure is to be given by directors “who are to authorise” the distribution, suggests that the statement must be given prior to the distribution. However, a distribution made without complying with the Distribution Procedure can subsequently be ratified by means of an ex parte application to the Royal Court of Jersey so that it can make an order that the distribution was lawful. The Court would need to be satisfied that pursuant to Article 115ZA(1) of the Law, (a) the relevant solvency tests could have been passed immediately after the distribution and on the determination of the application and (b) it would not be contrary to the interests of justice to do so. No shareholder approval is required, and no notice of the application need be given to any creditors of the company, or any other person, unless the court otherwise directs.

It is still possible just to treat the payment to the shareholders as a loan and convert this by way of set off into a distribution in the event that the affairs of the company do not require the payment to be treated as a distribution from the time it was made.

In assessing whether the relevant solvency tests could have been passed, the company must demonstrate that it has met the conditions in Article 115ZA(2) of the Law, being that:

- a. immediately after the distribution was made the company was able to discharge its liabilities as they fell due;
- b. at the time when the application is determined by the court the company is able to discharge its liabilities as they fall due; and
- c. where the distribution was made less than 12 months before the date on which application is determined: the company will be able to carry on business, and discharge its liabilities as they fall due, until the end of the period of 12 months beginning with the date on which the distribution was made.

Consequences of breach of Distribution Procedure & personal liability of directors

Solvency statement

A director who makes a Solvency Statement without having reasonable grounds for the opinion expressed in the statement is guilty of an offence punishable by up to 2 years imprisonment or a fine, or both (Article 115(5) of the Law). Further, under common law the directors who authorise an unlawful dividend may be held personally liable to reimburse the company for any distribution unlawfully made.

If a distribution is made without complying with the Distribution Procedure, then the member who received the distribution is liable to pay it or part of it (or, if the distribution was made otherwise than in cash, to pay a sum of equivalent value) if at the time of the distribution the

member knows or has reasonable grounds for believing that the distribution is made in contravention of the statutory requirements (Article 115A of the Law).

Breach of duty and relief

Where a director authorises a distribution, and as a result the company becomes insolvent, if the Royal Court finds that such a director has breached his duties to act in the best interests of the company and has failed to exercise the necessary care, diligence and skill, such director will be personally liable to the company for any damages incurred as a result of the breach.

Should an action for breach of duty be brought against a director, the director may apply to court to be relieved of any liability. The Law permits the court to relieve a director for a breach of duty, provided it is satisfied that:

- a. the director acted honestly and in good faith; and
- b. having regard to all the circumstances, the director ought fairly to be excused from liability.

Comment

The ability to make a distribution out of any source (other than nominal share account and capital redemption reserve for a par value company) provides flexibility, while the Distribution Procedure and sanctions provide sufficient safeguards for creditors.

However, although the Law only seeks to control distributions which reduce the net assets of a company, care should still be taken as certain transactions might, unintentionally or unwittingly, constitute distributions so that if the Distribution Procedure is not complied with, they might be unlawful. At the more obvious end of the scale might be transactions that involve a transfer of assets to a member at less than fair market value or a loan on less than commercial terms that almost certainly cannot be repaid. As regards the giving of a guarantee by a Jersey subsidiary in respect of its parent's obligations, if the guarantee is to be entered in the accounts as a note only because of the contingent nature of the obligation then it will not be a distribution.

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