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Duties of Directors of Guernsey Companies

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In the current economic environment, directors will be fully focussed on avoiding any breach of their fiduciary duties, particularly if they are directors of companies experiencing or at risk of financial distress.

This client briefing provides a general overview of the duties of directors of Guernsey companies in these circumstances and is not comprehensive. We recommend that clients obtain specific legal advice in relation to any individual matter which may concern them.

Who are the Directors?

A "director", as defined in the Companies (Guernsey) Law 2008 (the **Companies Law**) " includes an alternate director and any person occupying the position of director, by whatever name called". Therefore, in addition to formally appointed directors, and alternate directors, shadow directors and other persons occupying the position of directors (although not formally appointed as such) are subject to directors' duties.

Solvent Companies - Directors' Duties

Directors' duties in Guernsey arise from customary law, statute and contractual obligations but are not codified under the Companies Law and instead are drawn from the English common law duties in place prior to the introduction of the United Kingdom Companies Act 2006. This has been confirmed in multiple cases in the Royal Court of Guernsey, including the well-publicised *Carlyle Capital Corporation Limited (in Liquidation) and others v Conway and others* (Guernsey Judgment 38/2017). There are four fiduciary duties owed by directors to companies for which they are appointed and one "competence-based" duty. These are:

a. to act bona fide in the best interests of the company

b. to act for proper purposes/not to act for collateral or improper purposes

c. to exercise independent judgment

d. to avoid conflicts of interest, and

e. to exercise reasonable skill and care

In addition, the English case law in this area is highly persuasive in Guernsey (including the Court of Appeal and Supreme Court decisions in *BTI v Sequana* [2019] EWCA Civ 112 and [2022] UKSC 25).

Article 160 of the Companies Law provides for the ratification by a company of conduct by a director which exceeds his powers or amounts to negligence, default, breach of duty or breach of trust in relation to the company. This breach must be ratified by the members and may be taken by ordinary resolution unless the memorandum or articles require a higher majority (or unanimity).

Subject to the Companies Law, where the ratification resolution is proposed as a written resolution, members with a personal interest, direct or indirect, in the ratification are not eligible to vote on the ratification written resolution. Subject to the Companies Law, where the resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favour of the resolution by members with a personal interest, direct or indirect, in the ratification. These will however not apply in respect of ratification of conduct by a director which exceeds his powers.

Duty to Disclose Interests

Article 162 of the Companies Law provides that a director must immediately after becoming aware of the fact that he is interested in a transaction or proposed transaction with the company, disclose to the board of directors the nature and extent of his interest.

The above will however not apply if: (a) the transaction or proposed transaction is between the director and the company, and (b) the transaction or proposed transaction is or is to be entered into in the ordinary course of the company's business and on usual terms and conditions.

In addition, this may be supplemented by provisions in the company’s articles of incorporation preventing an interested director from voting or being counted in the quorum at the relevant board meetings considering the transaction.

Indemnities

Under Article 157(2) of the Companies Law, 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. This, however, does not:

a. prevent a company from purchasing and maintaining for a director of the company, or an associated company, insurance against any such liability

b. apply to any indemnity against liability incurred by a director to a person other than the company or an associated company subject to such indemnity provisions meeting certain requirements

Relief

Under Article 522 of the Companies Law, the Royal Court may relieve a director of liability in proceedings for negligence, default, breach of duty or breach of trust against the director. Any relief would be given on the basis that it appears to the Royal Court that the director has acted honestly, reasonably and having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused.

Companies in Financial Distress

When a company faces financial distress with the likelihood of becoming insolvent, while the duties set out above will continue to apply, the primary focus of a director's duties will be to consider creditors' interests and minimise loss to creditors.

The Supreme Court (in *BTI 2014 LLC v. Sequana S.A.* [2022] UKSC 25) confirmed that, where a company is insolvent or nearing insolvency, the directors' duty to act in the best interests of the company will also include the interests of the company's creditors as a whole (the "creditor duty"). This is a sliding scale, as the greater the company's financial difficulties, the more the directors should prioritise the interests of creditors. However, merely a "real risk" of insolvency was not deemed to be sufficient to trigger the creditor duty. It is engaged at the point that the directors know, or ought to know, that the company is insolvent or bordering on insolvency, or that an insolvent liquidation is probable. Where an insolvent liquidation is inevitable, the creditors' interests become paramount as the shareholders cease to have any valuable interest in the company. The directors must consider the interests of creditors as a whole rather than individual creditors.

Guernsey Insolvency Procedures

Under Guernsey law, a company becomes insolvent when it is unable to meet the solvency test. For non-regulated companies, it is a two-part test (cash flow solvency and balance sheet solvency). The cash flow solvency commonly called the cash flow test requires a company to demonstrate that it is able to pay its debts as they become due whilst the balance sheet solvency requires a company to show that the value of its assets is greater than the value of its liabilities. For regulated companies there is a third part to the test which concerns compliance with the solvency requirements imposed by their specific regulatory regimes. The solvency test is cumulative, meaning that a company is insolvent if it fails any applicable part of the test.

Failure of a company to meet the solvency test may result in the commencement of Guernsey insolvency procedures, of which the main procedures are administration, voluntary winding up or compulsory winding up under the Companies Law.

There is also an informal procedure known as "désastre" which is, in essence, a procedure for the recovery of debts and it is not a requirement that the debtor be insolvent or likely to become insolvent.

Following the commencement of winding up, a liquidator may apply to the Royal Court for:

a. orders to set aside or vary transactions previously entered into by the company, such as transactions at an undervalue and preferences, and/or

b. orders that the directors be held personally liable for wrongful or fraudulent trading

Wrongful and Fraudulent Trading

Under Article 434 of the Companies Law, a director may be personally liable for wrongful trading if, the company has gone into insolvent liquidation, and at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation and that person was a director of the company at the time. The Court shall not make a declaration if it is satisfied that the director took every step with a view to minimising the potential loss to the company's creditors that (assuming him to have known that there was no reasonable prospect of the company avoiding going into insolvent liquidation) he ought reasonably to have taken.

Under Article 433 of the Companies Law, any person (including a director) may be held personally liable for fraudulent trading if, in the course of winding up, it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose. As this action requires proof of fraud (which has a high burden of proof), wrongful trading actions are more common in practice.

Disqualification

Under Article 428 (3) of the Companies Law, if a director has engaged in wrongful or fraudulent trading, or has been found liable for other misconduct in connection with a company, the Royal Court may order that he or she should not be involved in the management of any company for a period of up to 15 years. If a person breaches a disqualification order, he or she will be personally liable for the company's liabilities incurred during such time.

Practical Steps Relating to Insolvency

From the point at which a director knows or should know that the company is or is likely to become insolvent, the primary focus of his or her duties shifts from acting in the interests of the company and its shareholders, to acting in the interests of its creditors. To ensure compliance with such duties and minimise any risk of personal liability, a director in these circumstances should:

a. continue acting as a director, while taking all reasonable steps to minimise the potential loss to creditors (resigning or ceasing to be involved in the company's management will not release a director from any existing personal liability)

b. obtain professional advice from lawyers and accountants, including on the current financial position of the company

c. keep regularly updated on the current financial position of the company, including whether the company is breaching any financial covenants in its finance documents (directors should not close their eyes to the reality of the company's position)

d. arrange for regular board meetings to monitor and discuss the company's financial position and steps to be taken to minimise loss to creditors, with the board meetings being fully minuted

e. if possible, obtain equity financing from shareholders and negotiate with creditors for waivers and amendments in relation to existing finance documents

f. liaise with major creditors in a pro-active way

g. regularly review options short of commencing insolvency proceedings, or determine whether the company should immediately cease to trade and commence insolvency proceedings itself if this is the only way to minimise further loss to its creditors

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