Duties of Directors of Jersey 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 Jersey 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" is defined in the Companies (Jersey) Law 1991 (the "Companies Law") as "a person occupying the position of director, by whatever name called". Therefore, in addition to formally appointed directors, 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' Statutory Duties

Under Article 74(1) of the Companies Law, a director of a Jersey company is obliged to:

(a) act honestly and in good faith with a view to the best interests of the company; and

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

These statutory duties are a codification of the common law fiduciary duties of directors (which, in practice, continue to be relevant when interpreting these duties). Such common law duties include a duty to act in good faith, a duty to act with diligence, a duty to exercise powers for their proper purpose and a duty to account for profits.

Although there is limited Jersey case law on directors' duties, the English case law in this area is highly persuasive in Jersey (including the recent Court of Appeal decision in BTI v Sequana [2019] EWCA Civ 112).

If a director breaches these statutory duties, Article 74(2) of the Companies Law provides that the breach can be absolved if all of the shareholders authorise or ratify the relevant act or omission, provided that the company will be able to discharge its liabilities as they fall due immediately following the relevant breach. Therefore, shareholder authorisation or ratification will not be effective when the company is (or will be) cashflow insolvent immediately following the breach.

Duty to Disclose Interests

Article 75 of the Companies Law provides that a director must disclose to the company any direct or indirect interest that he or she has in any transaction entered into (or to be entered into) by the company which materially conflicts with the company's interests. This may be supplemented by provisions in the company's articles of association preventing an interested director from voting or being counted in the quorum at the relevant board meetings considering the transaction.

Indemnities

Under Article 77 of the Companies Law, there is a general prohibition on a company providing an indemnity to directors, although there are certain exceptions, including:

(a) an indemnity for liabilities incurred by a director in successfully defending civil or criminal proceedings; and

(b) funding and maintaining directors' and officers' liability insurance.

Relief

Under Article 212 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 and having regard to all the circumstances of the case, he or she ought fairly to be excused.

Companies in Financial Distress

When a company faces financial distress with the likelihood of becoming insolvent, whilst the statutory 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.

Jersey Insolvency Procedures

Under Jersey law, a company becomes insolvent when it is unable to discharge its liabilities as they fall due (i.e. it is cashflow insolvent). This may result in the commencement of Jersey insolvency procedures, of which the main procedures are a creditors' winding up under the Companies Law or a désastre under the Bankruptcy (Désastre) (Jersey) Law 1990 (the "Désastre Law"). Following the commencement of insolvency proceedings, a liquidator (in a creditors' winding up) or the Viscount (in a désastre) 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 177 of the Companies Law and Article 44 of the Désastre Law, a director may be personally liable for wrongful trading if, prior to the commencement of a creditors' winding up or désastre, he or she knew there was no reasonable prospect of the company avoiding such proceedings or, on the facts known to him or her, was reckless as to whether such proceedings would be avoided. It is a defence for the director to show that from such point in time, he or she took reasonable steps with a view to minimising the potential loss to creditors.

Under Article 178 of the Companies Law and Article 45 of the Désastre Law, any person (including a director) may be held personally liable for fraudulent trading if, after the commencement of a creditors' winding up or désastre, it appears that the company's business has been carried on with intent to defraud creditors or for a fraudulent purpose. As this action requires proof of fraud (which has a high burden of proof), wrongful trading actions are more common in practice.

The Law Society of Jersey recently issued a practice statement on the application of Jersey's wrongful trading legislation during the COVID-19 pandemic which is available on the following link: https://www.jerseylawsociety.je/news-room/news/wrongful-trading-under-jersey-law-practice-statement/.

Disqualification

Under Article 78 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; and

(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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