

Directors' duties on insolvency of a Jersey company

With the deteriorated economic conditions resulting from Coronavirus, directors of Jersey companies are contacting us for advice on potential insolvency. We thought it would be helpful to summarise directors' duties as a Jersey company approaches insolvency, together with ideas on the practical steps that directors should take. A key consideration is the point at which the directors should start an insolvency process if they are to avoid personal liability. We know that the circumstances of each potential insolvency are different and, rather than just presenting a summary of the law, we work with directors to give practical advice applied to the particular situation.

Directors' duties as insolvency approaches

Under the Jersey Companies Law, a director of a Jersey company must:

- (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.

Where a Jersey company is in financial difficulty, the directors are subject to additional duties and potential liabilities. The interests of the company must be viewed primarily from the point of view of the creditors as opposed to the shareholders. The directors may be required to take steps to minimise losses of the company's creditors. Starting an insolvency proceeding may be in the best interests of creditors if the Company has no reasonable prospect of trading through financial difficulties.

What does insolvency mean? The statutory test in Jersey is cashflow insolvency – the inability to pay debts as they fall due. This does not necessarily mean a business must cease trading the moment it cannot pay a due debt – it is commonplace that companies experience such temporary difficulties, even at the best of times, without it being in the interests of the creditors to cease trading.

Before taking court proceedings the directors, taking advice where appropriate, should conclude that it is in the interests of creditors to incur the cost of triggering them. We think that the Courts are likely to be more tolerant of delayed payments as a result of issues created by the Coronavirus outbreak, than they would be in normal circumstances. We note that Australia has brought in measures which

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will make it considerably more difficult, for the time being, for businesses to pursue each other for insolvency remedies. It remains to be seen whether other jurisdictions will follow suit.

However, the current unusual circumstances are no excuse for not keeping a careful eye on these issues and taking decisive action where appropriate to prevent further loss to creditors. Directors may be found to be personally liable for the debts of the Company in circumstances of wrongful trading.

Jersey insolvency processes

If a company becomes unable to meet its debts as they fall due, the principal insolvency processes are:

- Insolvent winding up (a **Creditors' Winding Up**) under the Companies Law. This procedure (despite its name) may be commenced only by the insolvent company passing a special resolution.
- A declaration by the Court that the property of the insolvent company is en désastre (a **Désastre Declaration**) under the Bankruptcy (Désastre) (Jersey) Law 1990 (the **Désastre Law**). This procedure which be initiated by the insolvent company or by a creditor and involves liquidation of the company's assets to meet its liabilities followed by dissolution. The Court has a discretion to give further time to pay in appropriate cases, if the evidence suggests this will result in payment.
- A just and equitable winding up. The Court may order the winding up of a Jersey company on 'just and equitable' grounds under the Companies Law. The remedy is discretionary and has been applied flexibly by the Jersey courts.

Wrongful trading

If in the course of a Creditors' Winding Up or following a Désastre Declaration it appears that 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, and did not take reasonable steps with a view to minimising the potential loss to the creditors, the Court may order that the director be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company arising after that point.

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Jersey insolvency processes, cont.

The Court, if satisfied that a director is 'unfit', may order the disqualification of a director so that without leave of the court, he or she may not be a director of or in any way, directly or indirectly, concerned with or take part in the management of a company including, from Jersey, in a company incorporated outside Jersey. In order to justify a disqualification order, the behaviour must be serious. Shareholders may have a claim against directors for breach of duty to the company in certain circumstances and creditors may bring certain common law claims regarding the management of companies.

Practical steps

To help ensure compliance with his or her duties and to minimise any risk of personal liability as the company approaches insolvency, a director should:

- Ensure that regular board meetings are held to review finances and, for instance, the options available for the company to trade out of difficulty and / or raise finance;
- On an ongoing basis, obtain management accounting information on cash flows and liabilities of the company including timetabling critical points for raising additional funds;
- Ensure that the company takes professional advice, for example, from lawyers and accountants in respect of the current financial position of the company and how to minimise losses to creditors, as well as whether the company will breach any financial covenants in its finance documents;
- Where appropriate, directors should take the professional advice in their own capacity and pay for it themselves, otherwise, in the event of an insolvency procedure, the Viscount, liquidators and/or creditors will be entitled to see it in due course. They should also consider notifying insurers.
- Ensure that the company liaises with major creditors and, if possible, negotiates waivers and amendments in relation to existing finance documents;
- Ensure that, where possible, the company negotiates with creditors, for instance, to delay payments or to cap any liabilities or termination;
- Ensure that the company reviews and pursues potential sources of funding and capital;
- Ensure that the company avoids, as far as possible, incurring fresh liabilities that it may be unable to meet;
- Check the terms of directors' and officers' insurance;
- Ensure that careful minutes of board meetings are made and that records are kept of all advice that is received and all steps taken, as this will be evidence of the actions taken by the directors with a view to minimising potential losses to creditors.

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- Ensure that if a director dissents that their dissent is noted; a dissenting director may consider resigning but resigning or ceasing to be involved in the company's management will not release a director from any existing personal liability and may not satisfy the requirement to take reasonable steps to minimise potential loss, whereas there is authority that a dissent can release a director from any liability arising from the decision of the board against which they dissented;
- Regularly consider whether the company should immediately cease to trade and commence insolvency proceedings if this is the only way to minimise loss to its creditors.

Conclusion

It seems likely that the economic impact of Coronavirus will result in a number of insolvencies of Jersey companies. Directors should take advice as insolvency approaches. At Dickinson Gleeson we work with directors to give practical advice applied to the circumstances in order to gain the best outcome for companies, creditors and the directors themselves.

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