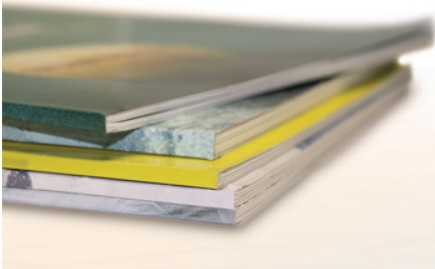


Alternative Investment Fund Directors – Experience Is Key

As originally appeared in Finance – Jersey Winter 2009/10



BY ALEX LAST

Introduction

The global financial crisis has reinforced the importance of ensuring that directors have sufficient knowledge and experience to discharge their duties effectively.

The purpose of this article is not to attempt to discuss in detail the duties of directors, but rather to highlight some of the issues that directors may face in times of financial crisis. In order to demonstrate the importance of ensuring that directors are appropriately qualified and experienced, this article is written with alternative investment funds in mind, where the risks to directors are perhaps more acute given the complexity of some of the investment strategies employed and the frequent use of leverage to enhance returns.

It is vitally important that all potential directors clearly understand their duties and responsibilities before accepting an appointment. In addition, directors must be certain that they will be able to devote sufficient time to the role, in order to actually discharge these duties and responsibilities effectively. This is especially important in times of financial distress when the nature of such duties shifts as the fund's financial condition deteriorates.

Directors Duties in a Nutshell

Broadly, the duties and responsibilities of directors of a Jersey company are governed by the **Companies (Jersey) Law 1991**, as amended (the "Companies Law") and the general common law.

The Companies Law enshrines in statute the general duties of a director to act honestly, in good faith, with due care, diligence and skill, in the best interests of the company. In addition, as a matter of common law, directors owe fiduciary duties to act in good faith, to exercise powers for a proper purpose, to avoid conflicts of duty and interest and to account for profits.

When a company is solvent, the directors owe legal and fiduciary duties to the company and its shareholders. When a company becomes, or may become, insolvent the position shifts and directors will also owe duties to creditors.

Accordingly, it is extremely important that directors take steps to understand and monitor the financial position of the company on an ongoing basis and start contingency planning at the first sign of potential financial difficulties.

In this regard, corporate governance is vital. In particular, directors should ensure that they obtain, review and understand sufficient information for them to be able to make informed decisions and that they document and keep accurate records of the steps taken in reaching such decisions.

The personal risks to directors of getting the financial analysis wrong are significant. For example, the Companies Law creates civil liability for wrongful trading where the court may order that directors become personally liable for the liabilities of an insolvent company. Furthermore, the Companies Law also creates an offence of fraudulent trading.

Experience is Key

In times of financial distress, the chances of litigation and other claims against the company and the directors increase. Therefore, it is likely that directors may be forced to make difficult decisions quickly, under pressure and in difficult circumstances.

In such a scenario, the first instincts of a director (particularly a non-executive) may be to seek to resign and walk away. However, it is precisely in such times of difficulty when the need for experience and guidance is most required. Directors considering this course of action must take care as if any such resignation would adversely affect the company there is a risk of a claim that the resignation itself may be a breach of the director's fiduciary duties.

Quality Not Quantity

Leaving aside the changing regulatory landscape and "onshore" tax issues, sophisticated investors are placing increased importance on the composition of the board of directors of corporate offshore funds from a governance and oversight perspective.

We are increasingly seeing a trend away from populating the "offshore" elements of boards purely with employees of local trust/administration companies (who, aside from often having inherent conflicts of interest may also be directors of numerous other funds). Instead, the focus is moving back towards the "old fashioned" approach of seeking to appoint a range of appropriately qualified directors with a spread of experience which is relevant to the strategy of the fund. Clearly, this tends to be more time consuming (and expensive) but it reflects the move away from the "cookie-cutter" approach to fund launches which has been prevalent (particularly in the hedge fund industry) over the last decade.

This re-balancing of priorities represents a clear opportunity for established and well regulated offshore jurisdictions, such as Jersey, to differentiate themselves once again from other offshore jurisdictions and to demonstrate their real value on the world stage.

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March 2010
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