

GUIDE TO DIRECTORS AND THEIR DUTIES IN THE ISLE OF MAN

CONTENTS

PREFACE	1
1. Position of Directors	2
2. Directors Duties of Care, Diligence and Skill	2
3. Directors Fiduciary Duties	3
4. Directors Powers of Delegation	5
5. Board Meetings	5
6. Administration and Accounts	5
7. Nominee Directors	6
8. Types of Directors	6
9. Personal Liability of Directors - Statutory Provisions	6

PREFACE

This Guide is intended to provide an overview of the duties imposed upon directors of Isle of Man companies.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the team, using the [contact information](#) provided at the end of this Guide.

Appleby

Isle of Man

February 2015

1. POSITION OF DIRECTORS

A company is a separate legal entity from its directors, shareholders and beneficial owners. It has its own legal personality and may be a party to contracts. Directors are not usually personally liable for the liabilities of the company but there are certain important exceptions to this principle. A company as an artificial person cannot perform its own acts. The directors act as agents for the company and the law of principal and agent regulate in many respects the relationship between the company and its directors.

Directors of a company are also, in a sense, in the position of trustees, although not in the strict sense of ordinary trustees. The legal and beneficial title to a company's property vests in the company as a separate legal person and the directors have no legal title to such property. However, directors are liable as trustees and if the directors of a company dispose of a company's property in breach of their fiduciary duty, they are treated as having committed a breach of trust.

The true position is that directors are in a fiduciary relationship with the company. The fiduciary relationship imposes upon directors duties of loyalty and good faith. As agents, directors are also under duties of care, diligence and skill.

If a person does not comply with his duties as a director he may be liable to civil and/or criminal proceedings and he may be disqualified from acting as a director. Set out below is a summary of the main duties of a director. It is not an exhaustive and complete statement of a director's duties and the law is subject to change. If a person is unsure about his duties as a director in any particular set of circumstances he should seek advice.

There is no distinction between executive and non-executive directors in discharging their duties. The responsibilities and duties they are subject to do not differ. Non-executive directors are widely recognised as having a useful and independent role to play in ensuring that the company's activities are undertaken in compliance with the law and in accordance with the principles of good corporate governance.

2. DIRECTORS DUTIES OF CARE, DILIGENCE AND SKILL

If directors of a company are negligent in performing their duties as directors they will be liable to the company for the damage caused by their negligence.

2.1 General Principles

A director owes a duty of care when carrying out functions in relation to the company. The standard of care which a director is required to exercise is the care that would be taken by a reasonably diligent person having both:

- the general knowledge, skill and experience that may reasonably be expected from a person carrying out the same functions as are carried out by that director in relation to the company (objective test); and
- the general knowledge, skill and experience that that director has (subjective test).

If a director's subjective abilities and skills enabled him to meet a higher standard than that of the reasonable director, then the standard of care owed by that director would be increased.

2.2 Reliance on Co-Directors and Officers of the Company

Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors. Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their

competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.

The reliance of a director upon his co-directors and the officers of the company must not be unquestioning. Directors have a duty to inform themselves about the business they are managing so that they are in a position to understand what is happening within the company and anticipate the potential implications for the company.

The collective responsibility of the board of directors of a company is of fundamental importance to corporate governance. That collective responsibility must however be based on individual responsibility. Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them.

2.3 Seeking Professional Advice

Directors are entitled to rely on qualified professional advice where it is appropriate to do so and may be considered negligent if they proceed to make a decision without first obtaining expert advice. This person must of course be qualified to give such expert advice but ultimately the directors must themselves exercise their judgment.

The overriding principle is that directors must act honestly and reasonably. However, each case will depend upon its facts and it is not possible to set out any hard and fast rules.

3. DIRECTORS FIDUCIARY DUTIES

As a result of their fiduciary position, directors owe a number of duties to their company. The general rule is that these duties are owed to the company and not to the company's shareholders and/or creditors and it is the company who can enforce them. The main duties include:

3.1 Duty to Act Bona Fide

(a) The Duty

Directors must act bona fide in what they consider – and not what a court may consider - is in the interests of the company, and not for any collateral purpose. This duty of honesty and good faith in the exercise of his powers is the primary fiduciary duty of a director.

(b) Subjective Nature of Duty

The duty to act bona fide in the interests of the company is a subjective one. The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind.

(c) The Interests of Whom

Directors are under a duty to act bona fide in the best interests of the company. This is generally taken to mean that whilst a company is solvent, a director in exercising his duty to the company is required to have regard to the interests of the company's present and future members. However, once a company is insolvent or if insolvency is a real possibility, there is a change of interest – in exercising their functions the directors are required to have regard to the interests of creditors who will be repaid from the company's assets. However, the director's duties are not owed to the members or to the creditors directly and continue to be owed to the company.

(d) **The Interests of the Group**

Where a company is part of a group structure the question arises whether a director must solely concern himself with the interests of the company alone or whether he may take into account the interests of the group as a whole. Each company in a group is a separate legal entity and the directors of a particular company are not entitled to sacrifice the interest of that company.

3.2 **Duty to Act for a Proper Purpose**

The duty of directors to act bona fide in the interests of the company and not for any collateral purpose imposes two duties on directors:

- the duty to act bona fide in the interests of the company (a subjective test – discussed above); and
- the duty to act for a proper purpose (an objective test).

Therefore even if a director has acted bona fide in what he believes to be the interests of the company, if he has exercised his powers for an improper purpose, he will still be in breach of his duties to the company. The directors must not exercise their powers under the company's articles of association for an improper purpose. For example, the power of allotment cannot be used to entrench the directors in office or to deprive an existing majority of its majority position.

The proper purpose principle has been applied to the exercise by directors of a range of discretionary powers, for example, the power to forfeit shares, to make calls, to refuse to register a transfer of shares or to allot shares. What constitutes a proper purpose cannot be stated in advance but must be ascertained in the context of the specific situation under consideration and, once ascertained, the court has to determine the substantial purpose for which the power was exercised in order to determine the validity of its exercise.

Directors may act for more than one purpose, some of which are proper and some of which may be improper. However, if the primary purpose for which the power was exercised was improper, a subsidiary proper purpose will not save the directors decision.

3.3 **Conflict of Duty and Interest**

Directors must not put themselves in a position where there is a conflict (actual or potential) between their personal interests and their duties to the company or between their duty to the company and a duty owed to another person. This principle may be applicable in a number of different situations.

If such a conflict does arise, a director is under a duty to disclose to the members in general meeting the nature of any interest he has in any transaction to which the company is or is to be a party. In the event of a director failing to disclose his interest to the members in general meeting, or the meeting refusing to sanction his interest, two consequences follow:

- the contract is voidable at the option of the company against any party thereto who has notice of the breach of duty; and
- any profit which the director derives from the contract is recoverable from him by the company.

A company is at liberty to waive the benefits of this equitable rule and to allow a director to make a contract with, or to be interested in a contract with, the company. In practice, the articles of association of a company almost invariably contain provisions which release the directors from the requirement to disclose their interest to the company in general meeting—replacing it instead with a requirement to disclose any interest to the board of directors.

3.4 **Secret Profits**

A director must not make a secret profit for himself from the use of corporate assets, information or opportunities. Directors are liable to account if what they did was so related to the affairs of the Company that it can properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors; and this resulted in a profit for themselves.

3.5 **Independence**

A director must not agree to restrict his power to exercise an independent judgment. This is a straightforward application of the “no-conflicts” rule. Equally directors must not fetter their discretion. This means that they must not enter into an agreement with a third party as to how they will exercise their discretion. To do so would prevent them from exercising an independent judgment at the appropriate time.

4. **DIRECTORS POWERS OF DELEGATION**

Directors must act collectively as a board and must adequately supervise the discharge of any delegated functions. Directors cannot delegate their powers unless they are permitted to do so. For example, if a company incorporated under the Companies Acts 1931-2004 has adopted the 1988 Table A, article 72 of that Table A expressly permits the directors of a company to delegate any of their powers to any committee consisting of one or more directors or to delegate to any managing director or any director holding any other executive office such powers as they desire.

Directors may also by power of attorney appoint any person to be the agent of the company for such purposes and on such conditions as they determine, including authority for the agent to delegate all or any of his powers. There are similar provisions in the Companies Act 2006 allowing a company to appoint a person as its attorney, allow the directors to delegate their powers to committees of directors and to appoint any person to be an agent of the Company.

5. **BOARD MEETINGS**

In order to ensure the board is conducting itself in a proper manner the importance of properly convened board meetings in providing protection for the directors cannot be overstated. It allows directors to monitor the progress of the company and also to document evidence should the directors need to justify their running of the Company.

It is important to ensure that minutes of meetings are recorded as soon as possible. The absence of a written record can at the very least indicate incompetence and, at worst, can lead to suspicions that the directors were trying to hide something.

If a company is to enter into a transaction it would be usual for the directors to meet to consider the position. The relevant documentation should be tabled, considered, approved and execution duly authorised at a duly convened and constituted meeting of the directors. Full minutes of the meeting should be kept so that the reasons behind the board’s decisions, as well as the decisions themselves, are documented. It is even more important to do this in the case of difficult or sensitive subjects. When a dissenting view is aired it should be carefully minuted.

6. **ADMINISTRATION AND ACCOUNTS**

The directors are responsible for the company’s administration, including maintenance of proper accounting records, minutes of meetings, statutory books and filing of information at the Companies Registry. It is usual for these duties to be delegated – the secretary of a 1931 Act company or to the registered agent of a 2006 Act company – but this does not relieve the directors of ultimate responsibility.

7. **NOMINEE DIRECTORS**

There is no such entity in Isle of Man law as a “nominee” director. Every director has exactly the same responsibility to the company as a whole and if a director neglects that responsibility in the interests of, or on the orders of, his principal, that director will be guilty of a breach of duty.

Directors should not allow others to unduly influence them in such a way as to undermine the exercise in good faith of their powers in the manner in which they consider to be in the best interests of the company. Any attempted “string pulling” whether by other directors, shareholders, beneficial owners or other third parties should be firmly resisted. Directors must make their own decisions, after receiving appropriate professional advice, if necessary. Directors must not simply “rubber stamp” decisions made by others. There are real and present dangers in acting as a “nominee” director. In order for a director to protect himself from being stigmatised as a “nominee director”, a director must not allow himself to be treated as a puppet.

8. **TYPES OF DIRECTORS**

Directors may be of three kinds:

8.1 **De Jure Directors**

De jure directors are directors who have been validly appointed to office in accordance with the company’s memorandum or articles of association by a directors or member’s resolution.

8.2 **De Facto Directors**

A de facto director is a person who assumes to act as a director. Such a person is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. This is established if a director undertook functions in relation to the company which could properly be discharged only by a director.

8.3 **Shadow Directors**

A shadow director does not claim or purport to act as a director. He claims not to be a director and is not held out as a director by the company. To establish that a person is a shadow director of a company it is necessary to allege and prove:

- who are the directors of the company, whether de facto or de jure;
- that the alleged shadow director directed those directors how to act in relation to the company or that he was one of the persons who did so;
- that those directors acted in accordance with such directions; and
- that they were accustomed to so act.

The concept of a “shadow director” does exist under Isle of Man law, although the term is not specifically referred to in our legislation. A “shadow director” is subject, in large part, to the same duties as a properly appointed director and can be liable for breach of those duties, even though the person was not aware that he was a shadow director.

9. **PERSONAL LIABILITY OF DIRECTORS - STATUTORY PROVISIONS**

9.1 **Fraudulent Trading**

“Fraudulent trading” is, in effect, an exception to the principle that a company is a separate legal entity, and as a director you can be personally liable for the liabilities of the company.

Under section 259 of the Companies Act 1931, if in a winding up it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose the court

may declare that any of the directors, whether past or present, who were knowingly party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all or any debts or other liabilities of the company. The term "director" includes de jure, de facto and shadow directors as discussed above. By virtue of section 182 of the Companies Act 2006, section 259 of the Companies Act 1931 will also apply to a company incorporated under the Companies Act 2006 as if it was a company incorporated under the Companies Act 1931.

If a company is in financial difficulties it may have to stop trading. This though is not always the best solution. For example it may, in certain situations, minimise the loss to creditors if the company trades on to complete an order or contract in order to realise a substantial payment or in order to preserve the business as a going concern until a sale of the business can be achieved. If trading is to continue however the greatest care should be taken to avoid the possibility of liability for fraudulent trading. It should also be noted that, just by resigning, a director will not be discharging his duties.

If a company is suffering financial difficulties then directors should take immediate legal and accountancy advice. The best option would normally be to cease trading to ensure that no new liabilities are created or amounts due to existing creditors increased, but each case must be considered on its own facts.

9.2 Misfeasance

"Misfeasance" is, in effect, another exception to the principle that a company is a separate legal entity and is another area where directors can be personally liable.

Section 260 of the Companies Act 1931 gives a liquidator the right to examine the conduct of any person who has taken part in the formation or promotion of the company, or any past or present director, manager, liquidator or any officer of the company. If the court is satisfied that any such person has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may examine into the conduct of that person and compel him to repay or restore the money or property or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance, or breach of trust as the court thinks just.

By virtue of section 182 of the Companies Act 2006, section 260 of the Companies Act 1931 will also apply to a company incorporated under the Companies Act 2006 as if it was a company incorporated under the Companies Act 1931.

9.3 Unlawful Distribution – Companies Act 2006

The Companies Act 2006 introduced a new concept of "Distribution". This includes the direct or indirect transfer of company assets, to or for the benefit of the member; or the incurring of a debt to or for the benefit of a member and includes the payment of dividends and the redemption, purchase or other acquisition by a company of its own shares.

Directors of a 2006 Act Company may authorise a distribution by the company to members at such time and of such amount as they think fit if they are satisfied, on reasonable grounds, that the company will, immediately after the distribution, satisfy the solvency test.

The solvency test is satisfied if:

- the company is able to pay its debts as they become due in the normal course of the company's business; and
- the value of the company's assets exceeds the value of its liabilities.

However, if a distribution is made by a company to a member and the company did not, immediately after the distribution, satisfy the solvency test, then the distribution may be recovered by the company

from the member. In addition, a director of the company who failed to take reasonable steps to ensure that the distribution was made in accordance with the requirements of the Companies Act 2006 will be personally liable to the company to repay to the company so much of the distribution as cannot be recovered from members.

9.4 Power of Court to Grant Relief in Certain Cases

The Companies Act 1931 contains a section which allows the court to relieve a director, manager, officer or auditors of a company from liability. Section 337 of the Companies Act 1931 provides:

"If in any proceedings for negligence, default, breach of duty, or breach of trust against (a director, manager, officer or auditor of a company) it appears to the court hearing the case that that person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court may think fit."

Equally if a director, manager, officer or auditor of a company has reason to apprehend that any claim might be made against him in respect of any negligence, default, breach of duty or breach of trust, he can apply to court for relief.

A similar provision is included in section 99 of the Companies Act 2006, although this does not extend to the managers, officers or auditors of a company.

For more specific advice on directors and their duties in the Isle of Man, we invite you to contact:

Isle of Man

Faye Moffett

Partner, Group Head, Isle of Man

Corporate

+44 (0)1624 647 631

fmoiffett@applebyglobal.com

For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found [here](#).