How to be a dutiful director: a refresher on BVI director duties, risk and mitigation

"When I grow up, I still want to be a director." – Stephen Spielberg

The esteemed Mr. Spielberg[1] was (probably) talking about a different type of director, but being a director of a British Virgin Islands company is not the daunting task it may first appear. Acting as a director of any company, anywhere in the world, is not a task that should be taken lightly but the duties of a director of a BVI company are, as we will try to show below, relatively easy to understand and reasonably easy for prudent directors to comply with.

In addition, there are tools available to manage and mitigate the risk which directors should consider using, and we take a look at some of the options below.

1. Sources of BVI law

The main source of BVI law relevant to directors is the BVI Business Companies Act 2004 (the ***Act***). The Act created a statutory set of duties, which apply to all directors of a BVI company.

Prior to the Act coming into force, the primary source of such duties was the common law, which had established (over centuries) a series of fiduciary obligations on directors. Unlike similar corporate statutes in other common law jurisdictions, the Act did not expressly codify and replace those historic duties, and accordingly they appear to remain good law in the BVI. There is considerable overlap between the common law and the Act and in most circumstances it is not necessary to consider the two separately.

Directors, particularly of companies in financial difficulty, should also be cognisant of the duties arising under the BVI's Insolvency Act 2003.[2]

2. What (and who) is a director?

The Act contains a statutory definition of a director which "includes a person occupying or acting in the position of director by whatever name called." Accordingly, if a person has not been formally appointed a director (for example, because of some procedural defect in the appointment, or simply because no thought was given to the nature of his role) but acts as a director, he will not escape liability for breach of duty.

All BVI companies are required to have at least one director, although that director does not have to be a natural person. There is no requirement for directors to be a BVI resident or citizen.[3]

The provisions of the Act do not appear to catch so-called 'shadow directors', or persons on whose instructions the board is accustomed to acting, so shareholders, professional advisers and others who may express a view on the direction of the company do not generally need to be concerned with directors' duties (outside of the context of insolvency, where, as discussed further below, liability for 'shadow directors' – and de facto directors – is expressly provided for).

Case law has suggested that where a director is itself a corporate body, the persons who are directors of the corporate director will not, without more, be treated as shadow directors or de facto directors of the company for which the corporate body acts as director.

3. Duties and Liability under the Act

The principal statutory duties of a director under the Act can be summarised as:

a) to act honestly and in good faith and in what the director believes to be in the best interests of the company when exercising his powers as a director (the ***best interests duty***);

b) to exercise the reasonable care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,

   i. the nature of the company;

   ii. the nature of the decision; and

   iii. the position of the director and the nature of his responsibilities (the ***reasonable skill duty***);

c) to exercise his duties for proper purpose and in accordance with the Act and the memorandum and association of the company (the ***proper purpose duty***)

d) to disclose any interest which he has in a transaction entered into or to be entered into by the company (the ***disclosure duty***).

Best interests

There are three important possible modifications to the best interests duty (in each case only where there is an express provision made in the memorandum and articles of association of the company (the ***Mem & Arts***)):

a) the director of a wholly-owned subsidiary company may act in a manner which he believes is in the best interests of that company's holding company even though it may not be in the best interests of the company;

b) the director of a company that is a subsidiary, but not a wholly-owned subsidiary, may, with the prior agreement of the shareholders other than its holding company (ie with the agreement of the minority shareholders), act in a manner which he believes is in the best interests of that company's holding company even though it may not be in the best interests of the company; and

c) a director of a joint venture company may act in a manner which he believes is in the best interests of a joint venture party, even though it may not be in the best interests of the company.

The best interests duty is a subjective test which goes to the motivation of the director himself. A decision made in the honest belief that it is the best course of action will not be a breach of this duty (although it may be breach the reasonable skill duty) even if that decision turns out to be a poor one. Practically speaking, of course, the worse the decision, the harder it may be to argue that it was entered into in good faith.

By taking into account the nature of the company, the best interests duty seeks to strike a balance for companies that pursue risky ventures in volatile markets or jurisdictions.

Reasonable skill

The reasonable skill duty is an objective test, which goes to how a hypothetical 'reasonable' director would have acted in the same situation as the director and effectively sets a minimum standard of care. Board papers and minutes which clearly show the rationale for the decision and the factors considered by the directors can all be helpful in showing that the duty was met. Courts have traditionally been reluctant to 'second guess' commercial decisions when there is evidence that they have been properly considered.

Although the Act does not refer to the actual skill, knowledge and experience of the director, there is a long established common law principle that a director with particular knowledge and experience may be held to a higher standard (so, for example, a director with a legal background might be expected to have thought more carefully about legal risk than a lay director), which presumably continues to apply.

Interested transactions

It is worth noting that the disclosure duty does not go so far as to require directors to avoid conflicts of interest, only to declare them. A transaction in which a director has an interest will still be valid if the interest was disclosed to the board beforehand. The Act also provides that the decision will not be voidable if the transaction is approved by the company's members (provided that they have been made aware of the material facts and the company has received full value). Any disclosure of interests should be clearly documented in board resolutions or minutes.

Unless there is a provision to the contrary in the memorandum or articles of association of the company, the interested director may attend a meeting on, vote to approve, or even sign documents relating to, the transaction (assuming it has been properly disclosed).

Proper purpose

The Act does not specify the meaning of 'proper purpose' and although the term is derived from a fiduciary concept on which there is substantial case law, there is perhaps surprisingly no established definition.

In essence, the concept of proper purpose requires that a power or discretion is exercised for the reason which that power or discretion was granted. In practice, any corporate action that is for a legitimate commercial purpose, which is lawful and a foreseeable use of a power of the company should not fall foul of the duty. For example, issuing shares because the company needs to raise capital is a proper purpose but, as a recent case in the BVI has made clear, issuing shares with the intent to change the balance of voting power between the shareholders is not.

The proper purpose duty also requires compliance with the Act and the Mem & Arts (essentially giving both the statute and the constitutional documents 'teeth' by making the directors duty bound to comply with the Mem & Arts and the

Act and creating a danger of personal liability for breach). Clearly, it is important for directors to understand the requirements of the Mem & Arts and their legal obligations generally and to seek legal advice where in doubt.

4. Fiduciary Duties (duties under the common law)

As discussed above, in the absence of any express wording in the Act to the contrary (or a deciding case), the common law duties of directors appear to still apply as a matter of BVI law. The key duties, and their overlap with the statutory duties, are set out very briefly below:

Duty not to exceed powers: It is hard to envisage a circumstance in which a breach of this duty would not also be a breach of the statutory duty to act in accordance with the Act and the Mem & Arts of the company.

Duty not to make a personal profit: This duty overlaps with both the statutory best interests duty and the duty to disclose but could be considered more onerous. It is not clear that approval of a transaction in which a director has an interest by the members (as contemplated by the Act) will allow him to escape liability under the common law.

Duty not to usurp a corporate opportunity: A director who usurps a corporate opportunity presented to the company (for example, by diverting it to a company owned by him) is likely to be also in breach of his statutory best interests duty. The common law position is that the director is liable to repay to the company any profit made by him.

Duty not to compete: Unlike in other jurisdictions where the common law duties have been codified, there is no statutory duty on directors not to compete with their company in the BVI (although, again, this could be considered not to be acting in the best interests of the company) – and no statutory disclosure process through which the director can disclose the competition and be absolved of liability by the board or shareholders. Although case law has suggested merely being a director of a competing company will not breach the duty, the (assumed) continued existence of the common law duty may be problematic for professional directors and others who have multiple directorships with companies in the same industry. Given the BVI's status as an offshore financial centre in which such professional directors are common, it may be that the decision not to include a statutory duty covering this ground was deliberate.

Duty to act bona fide in the best interests of the company: The best interests duty as enshrined in the Act appears to effectively restate this duty, so that it is unlikely to need to be considered separately.

Duty to act for a proper purpose: Again, the Act appears to have restated the duty to act for a proper purpose in its entirety.

Duty of skill and care: Again, this fiduciary duty overlaps considerably with the reasonable skill duty under the Act, although the manner in which it has been expressed in the common law is subtly different. In particular, case law has traditionally applied a test which is both subjective and objective (specifically, having regard to both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and (b) the general knowledge skill and experience that that director actually has).

5. Liability for breach of duty

The Act makes clear that a director is not generally personally liable for any debt, obligation or default of the company. However, there may be personal liability for the directors where they or the company have exceeded their powers or there has been a breach of duty or negligence by them. With the exception of the failure to disclose an interested transaction (which carries a fine of US$10,000 on summary conviction) the consequences of a breach of duty have not been set out in the Act, but presumably follow the common law position, where damages have been calculated on a tortious basis (ie based on putting the company in the position it would have been in had the breach not occurred). This could include paying compensation for losses, returning any property belonging to the company and paying the company over any profit improperly made by the director.

The duties of directors are principally owed to the company itself and not to its shareholders or creditors, and as such the proper claimant in such an action should usually be the company itself. The Act contains detailed provisions setting out where a 'derivative' action (an action brought by a member on behalf of the company) may be brought, which are outside the scope of this advice.

It should also be noted that in a situation where a company is insolvent or is likely to become insolvent, then the directors will owe their duties to the company with reference to the general body of creditors (rather than the members).

Directors may also attract personal liability (and in serious cases, criminal penalties) for failing to respond to, or giving false information in response to, regulators such as the International Tax Authority.

6. Duties and Liability under the Insolvency Act

Directors of a company should also be aware of the duties imposed under the Insolvency Act 2003. Of course, these duties will be of particular relevance to the directors of a company that is experiencing financial difficulties, or which is contemplating a transaction which may place a company into a position of financial difficulty (although consideration of the latter is outside the scope of this memorandum).

The Insolvency Act is relatively broad in its application to the duties of directors. The Insolvency Act definition of "director" is far wider than the definition contained in the Business Companies Act and includes:

- "a person occupying or acting in the position of a director by whatever name called" – this would include both executive and non-executive directors.

- "a person in accordance with whose directions or instructions a director or the board of a company may be required or is accustomed to act." – this extends the application of the Insolvency Act to de facto directors.

- "a person who exercises, or is entitled to exercise, or who controls, or is entitled to control the exercise of powers which, apart from the memorandum and articles, would fall to be exercised by the board" – this extends the application of the Insolvency Act to "shadow directors".

The provisions which are of particular relevance to directors are found in Part IX and Part X of the Insolvency Act, and are described briefly below. It is important to note that only a liquidator has the power to apply to the Court for relief under these provisions, which pre-supposes that the company is in insolvent liquidation.

Summary remedy against delinquent officers and others

This provision allows the court to make an order where a person (see the following paragraph as to who may be liable) has misapplied or retained or become accountable for any money or any assets of the company, or has been found guilty of any misfeasance or breach of any fiduciary or other duty to the company.

The operation of this provision extends to a person who, inter alia, is or has been an officer of the company, or someone who has been involved in the promotion, formation, management or liquidation or dissolution of a company. The Insolvency Act defines an "officer" to include a director or secretary of the company.

The court can order the person to repay, restore or account for any money or assets, or pay compensation in respect of any misfeasance or breach of duty.

Fraudulent trading

When any of a company's business has been carried on with intent to defraud its creditors, or the creditors of any other person, or for any fraudulent purpose, the court can order any person who was knowingly a party to the carrying on of the business in such manner to make a contribution to the company's assets to the extent that the court considers appropriate. The operation of this provision extends to "any person" with knowledge of the fraudulent acts.

Fraudulent conduct

In addition to the fraudulent trading provisions, a person who is or has been an officer of the company is deemed to have committed an offence if, at any time whilst an officer of the company or within 12 months preceding the commencement of the liquidation he has:

- made or caused to be made any gift or transfer of, or charge on, or has caused, permitted or acquiesced in the levying of any execution against the company's assets; or

- has concealed or removed any of the company's assets since, or within, 60 days of the date of any unsatisfied judgment or order for the payment of money obtained against the company.

However, it will not be considered an offence if the officer can show that he had no intent to defraud the company's creditors or in the case of a gift, transfer or charge, etc it occurred more than five years before the commencement of the liquidation.

Insolvent trading

This offence only applies to directors or former directors. The court may order a director or former director to contribute to the company's assets where, at a time when he was a director of the company but before the commencement of liquidation, he knew or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation and he failed to take every step reasonably open to him to minimise the loss to the company's creditors.

The facts which a director of a company ought to know or ascertain, the conclusions he ought to reach and the steps reasonably open to him which he ought to take are those which would be known or ascertained or reached or taken by a reasonably diligent person having the general knowledge, skill, and experience that may reasonably be expected of a person carrying out the same functions as the director in question and the general knowledge, skill and experience of that director (ie the test is made up of both objective and subject elements).

Extent of liability

It is worth noting that the liability of directors and/or officers, as the case may be, under the Insolvency Act for fraudulent trading and insolvent trading is of a compensatory rather than of a penal nature and any shortfall in a company's assets which is being sought from the relevant person to meet creditors' claims would be calculated on an indemnity rather than a damages basis with no scope for punitive damages. The offence of fraudulent conduct, however, does attract a penal penalty and/or a fine (US$10,000 fine, imprisonment for three years or both).

The court also has the power to make a disqualification order against a delinquent director. If such an order is made it will prevent that director from engaging in any prohibited activity, without the leave of the court, for a period determined at the discretion of the court. The prohibited activities include, but are not limited to, acting as a director of a company, or in any way directly or indirectly, being concerned or taking part in the promotion, formation or management of a company. If a person, subject to a disqualification order, engages in a prohibited activity he commits an offence which attracts a penal penalty and/or a fine (US$7,500 fine, imprisonment for two years).

7. How to manage and mitigate the risks?

Indemnification

Under section 132 of the Act, a company may, subject to its Mem & Arts, indemnify its directors (or former directors) against all expenses, including legal fees, and against all judgments, fines and amounts paid in settlement and reasonably incurred in connection with legal, administrative or investigative proceedings. Such indemnification is, however, only permitted where the director acted honestly and in good faith and in what he believed to be in the best interests of the company, and in the case of criminal proceedings, the person has no reasonable cause to believe that the conduct was unlawful.

It does not appear to be possible to contract out of these limitations so that a company may choose offer wider indemnities to the board. However, this restriction could be avoided if the shareholder (or any entity higher up the corporate chain granted the indemnity).

There are several very good reasons for directors to not rely solely on indemnification under the Act or the articles of the company. Firstly, many BVI companies are single asset or shell companies with limited covenant strength, and if there is a claim against the directors for breach of duty, it is unlikely that the company is in rude financial health. Secondly, the act only states that the company may so indemnify the directors – in other words, the company has the power to do so, but does not have an obligation to do so. The company could also change its articles and dis-apply section 132 at any time - so former directors are to some extent at the mercy of their successors when claiming for indemnification.

As a result, a prudent director will seek a contractual indemnity from the company and, ideally, the shareholder or a company up the corporate chain with real substance. Such indemnities are included in most service agreements (and the terms and conditions of most corporate directors).

D&O polices

A range of director and officer policies are commercially available to help protect directors from personal liability, including for breach of duty. Such policies are expressly permitted under the Act.

As with all insurance policies, D&O policies are invariably subject to a number of exceptions and limits which the directors should consider carefully. In particular, most policies will not pay out where the director has been grossly negligent or acted in bad faith. As such they should not be regarded as a complete shield to liability.

Interestingly, the Act permits insurance coverage to have a broader scope than indemnification by the company – but that does not mean that such coverage will be available in the market place. As with all insurance, the wider and deeper the cover, the more it is likely to cost.

Advice and records

A director is entitled to rely on the register of members and upon books, records, financial statements and other information prepared or supplied, and on professional or expert advice given, by:

a) an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned,

b) a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence; and

c) any other director, or committee of directors upon which the director did not serve, in relation to matters within the director's or committee's designated authority.

The director must, however, act in good faith and make proper enquiry when the circumstances suggest it is needed and will not be entitled to rely on advice or records where he knows such reliance is unwarranted.

When directors are uncertain as to the best course, particularly where difficult legal issues arise, taking advice from a BVI lawyer may ultimately be the best way for them to mitigate their risk and protect themselves. Directors should also take sensible practical measures, such as making sure all decisions (particularly key decisions) and the reasons for those decisions, are properly recorded in written resolutions and minutes.

8. Conclusions

If, like Spielberg, you still want to be a director of a BVI company, or if you are lucky enough to already be, we would be happy to provide you with more tailored advice to your circumstances and advice on how best to mitigate your risks. If you have any questions on any of the matters mentioned above, please feel to contact George Weston or your usual Harneys contact.

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[1] Indiana Jones and the Kingdom of the Crystal Skull, notwithstanding.

[2] Directors of BVI companies which are carrying on regulated activities which are subject to separate legislation – for example under the Securities and Investment Business Act 2010 – will also need to be cognisant of their duties, and the scope for liability under that legislation, but in the interests of brevity they are outside the scope of this article.

[3] Under the Economic Substance (Companies and Limited Partnerships) Act, 2018 (the Act), which came into force on 1 January 2019, companies carrying on certain activities are required to have 'adequate' economic substance – in some circumstances this may potentially include local directors, officers or employees.