

This Memorandum provides a non-exhaustive summary of the duties and obligations of directors of investment companies under Bermuda law. Where a Company is incorporated in Bermuda, the position of the directors serving on the board will be regulated by Bermuda law and references are to Bermuda statutes except where indicated.

As a general principle, where duties and liabilities of directors are not specifically described or referred to under Bermuda law, then they do not differ fundamentally from English common law.

Shares of a Company listed on an approved stock exchange will be subject to the listing requirements of the relevant stock exchange and as a result there will be additional duties imposed on the directors and officers, as a result of this listing that are not governed by Bermuda law.

An investment fund registered under the Investment Fund Act 2006 is also subject to the supervision, regulation and inspection of the Bermuda Monetary Authority (**BMA**).

1. INTRODUCTION

Bermuda law does not impose an all-embracing code of conduct on directors. In practice, a company's memorandum of association and bye-laws comprise its constitution and together with the Companies Act 1981, as amended (**Companies Act**) prescribe the ambit of the directors' powers. Accordingly, if the directors act *ultra vires* the company's constitution, they are answerable to the company. The function of the substantive law is to supplement the internal constitutional checks on a director's powers and to deal with areas where the company's constitution may be silent.

Many of the duties and obligations of a director are statutory; others are found only in common law. The Companies Act contains numerous provisions relating to the duties of directors and prescribes penalties for breach of such duties. The Companies Act makes no distinction between executive and non-executive directors; non-executive directors are directors for all purposes of the Companies Act.

2. THOSE TO WHOM DIRECTORS' DUTIES ARE OWED

2.1 To the Company/To the Shareholders

Directors are responsible to the company, not to the shareholders. The courts tend to recognise the difficulty of identifying the interests of such an artificial abstraction and in practice regard the interests of the company as identical with those of the shareholders as constituted from time to time therefore avoiding identification of the company's interests with specific members or encouraging short-termism to the detriment of the company as a going concern. There are, however, some circumstances, such as calling meetings, preparing financial

statements, recommendations to shareholders etc. where the directors may owe duties to shareholders on an individual basis.

2.2 To Creditors

The directors ordinarily owe no duty of care to the company's creditors except where insolvency is foreseen. However, insolvency inverts the normal position as creditors have priority over shareholders in a distribution on winding up, and thus their interests are seen to take precedence, so they, rather than the shareholders, become the beneficiaries of the directors' fiduciary obligations and duty of care and skill.

3. COMMON LAW DUTIES OF DIRECTORS

At common law a director owes two types of duty to the company; a fiduciary duty and a duty of skill and care.

3.1 Fiduciary Duty

The fiduciary duty has four aspects:-

1. **Duty to act bona fide in the interest of the company:** A director must act in what he honestly believes to be the best interest of the company. Only if no director could have reasonably believed that the action taken was in the best interests of the company will the courts intervene.
2. **Duty to exercise powers for a proper purpose:** This is a newer and somewhat vaguer duty than the duty to act in good faith in paragraph 1.1 above. The courts will inquire what the proper purpose of a power given to directors was. A power exercised for an improper purpose may be set aside. Thus taking the most common situation in which this rule has been applied, directors may not issue shares to destroy an existing majority or create a new majority but only for the purpose of raising capital.
3. **Conflicts of interest:** A director must not put himself in a position where there is either an actual or potential conflict between his personal interest and his duty to the company. This common law provision is qualified by the statutory requirements relating to disclosure of "*material interests*" (see paragraph B 1.2); by any additional provisions in the bye-laws of the company and to the extent that the company gives its approval therefore in a general meeting and is not otherwise restricted from doing so by the bye-laws.
4. **Secret profits:** A director's fiduciary position precludes him from making a personal profit from any opportunities of which he becomes aware or which are available to him as a result of his directorship, even if he is acting honestly and for the good of the company, unless he has the approval of the company. This applies equally to contracts with the company and with third parties. Any profit arising in such circumstances must be accounted for, i.e. paid over to the company. If the opportunity to profit arose through his directorship the director will be liable to account for the profit irrespective of the company not being interested in, or not being able to take advantage of, the opportunity. Again, this rule is subject to waiver by the company in general meeting or dispensation in the bye-laws of the company.

The fiduciary duties are essentially of a negative, prohibitive nature: they do not generally require positive action.

3.2 Duty of Skill and Care

In contrast to the fiduciary duties, the duty of care and skill does involve positive obligations to act. It is also considered to have 3 aspects:

1. **Degree of care, diligence and skill:** a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience (a subjective test). Performance must be judged by the way the director applies any skills which he or she actually has. However, it has been suggested that directors have a duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors.

It was once thought that the obligations of non-executive directors were not very onerous. However, it has been suggested that there ought to be no difference between the skill demand of an executive and non-executive director, at least where the latter is professionally qualified.

In the case of a public company, a director who holds office as an executive shall exercise that degree of care, diligence and skill which a reasonably prudent and competent executive in his position would exercise.

2. **Attention to the business:** A director must diligently attend to the affairs of the company. Mere errors of judgement have been held not to breach the duty of skill and care. It has been held that a director is not bound to give continuous attention to the affairs of the company as his or her duties are of an intermittent nature.
3. **Reliance on others:** A director is entitled to rely on his fellow directors and the other officers of the company. He can delegate power to others where it is reasonable to do so provided that, in the case of a public company, this delegation shall not constitute an assignment of his office. Moreover directors cannot absolve themselves entirely of their responsibility by delegation to others.

Although there appears to be no case law directly on point, non-executive directors would seem to have certain duties of supervision which must be fulfilled before they can safely delegate responsibilities to others. For example, when appointing managers, the directors must be duly satisfied that the managers have the requisite skills to discharge the functions delegated to them. In addition, the directors must ensure that there is set up an adequate system of monitoring the managers. The directors must on a regular basis ensure that the managers have fulfilled their obligations. The directors should require a regular flow of information from the managers to ensure that they are carrying out their duties satisfactorily.

4. STATUTORY DUTIES OF DIRECTORS

Some of these duties are imposed not on the directors themselves but on the company. However, since the directors are responsible for the performance of the statutory duties imposed on the company, it is they who must ensure that the company does everything that is required of it. The principal relevant statutory duties are outlined below.

4.1 Section 97 Companies Act 1981

Section 97 of the Companies Act provides as follows:

1. Duty of Care of Officers:

"(1) Every officer of a company in exercising his powers and discharging his duties shall:

- (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,*

(2) Every officer of a company shall comply with this Act, the regulations, and the Bye- Laws of the company....."

"(4) Without in any way limiting the generality of sub-section (1) an officer of a company shall be deemed not to be acting honestly and in good faith if:

- (a) he fails on request to make known to the auditors of the company full details of:*

- (i) any emolument, pension or other benefit that he has received or it is agreed that he should receive from the company or any of the company's subsidiaries; or*
- (ii) any loan he has received or is to receive from the company or any of its subsidiaries:*

- (b) he fails to disclose at the first opportunity at a meeting of directors or by writing to the directors:*

- (i) his interest in any material contract or proposed material contract with the company or any of its subsidiaries;*
- (ii) his material interest in any person that is a party to a material contract or proposed material contract with the company or any of its subsidiaries."*

"(5A) An officer is not liable under sub-section (1) if he relies in good faith upon:

- (a) financial statements of the company represented to him by another officer of the company; or*
- (b) a report of an attorney, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him....."*

Section 97(1) of the Companies Act is derived from Canadian legislation and it is considered that the provision does impose a higher standard of care upon directors than the common law, namely an objective standard.

2. Disclosure requirements:

Under Section 97(4) of the Companies Act, a director must disclose to the company any material interest he has in a contract to which the company or any of its subsidiaries is, or is to be, a party, and any

interest he has in shares of the company. Notification of any interest in any contract of transaction or shares in a company or any of its subsidiaries with which the company proposes to enter or has entered into must be disclosed to the meeting of the directors of the company at which the contract or transaction is first taken into consideration or to the first meeting of the directors held after the interest arises. A general notice given to the other directors to the effect that he is an officer or member of a specific body of persons whether corporate or incorporate and is to be regarded as interested in any contract which may, after the date of the notice, be made with that body shall be a sufficient declaration of interest in relation to any contract or transaction so made. A direct or indirect beneficial interest of not more than 10% of a person's capital is not deemed material for the purposes of the Companies Act.

3. **Acquisitions by/from directors:**

This requires a director who wishes to acquire from the company or transfer to the company assets exceeding a certain value, to have that contract or arrangement approved by a general meeting of the company. A court may order restitution or payment of damages against an offending director.

4. **Loans to Directors:**

Section 96 of the Companies Act requires that a loan, or the giving of any security or guarantee in connection with a loan, to a director or his spouse, children or a connected company is approved by members holding in the aggregate not less than nine-tenths of total voting rights. There are certain exceptions thereto.

4.2 **Accounting Responsibilities of Directors**

The Companies Act requires every company registered in Bermuda to keep proper accounting records. A report and audited accounts unless waived by all directors and shareholders must be prepared annually. However, the Company is a collective investment scheme and so pursuant to the CIS Regulations must undertake an annual audit unless specifically exempted from this requirement by the BMA.

The audit must be carried out by an independent auditor who is a member of a recognised institute.

4.3 **The Financial Responsibilities of Directors**

The extent of many of the directors' powers is set out in a company's bye-laws which operate alongside the other common law, statutory and regulatory requirements. For example:

Directors must exercise their general duty to exercise skill and care in financial matters:

1. **Control over the company's borrowings:** The bye-laws may place a limit on the amount a company can borrow without members' approval. If the directors exceed their borrowing powers the loan is generally valid unless the lender is aware of some irregularity, but the directors risk personal liability.
2. **Control over the dividend policy of the company:** Common practice is to give the board power to pay interim dividends and to declare a final dividend subject to members' approval. However, the precise rules laid down in the bye-laws vary from company to company. Directors responsible for paying an illegal dividend may be personally liable to repay the company.

3. **Control over the issue of shares:** Under Bermuda law, there are no statutory restrictions on the duties of directors in relation to the issue of shares. However, the directors must have regard to their general fiduciary duties for example they must only issue shares for a proper purpose.

4.4 Operational Duties

The Companies Act imposes various duties and responsibilities on directors with regard to the operation of a company. Some of these duties are specifically noted in this Memorandum and these include the keeping of minutes of meetings, keeping of books of accounts, making certain information available to certain persons and such other general duties as are contained within Part VI of the Companies Act.

4.5 Potential Liability for Breach of Statute

Further, the Companies Act provides for certain situations where directors, officers and others may be liable:

1. **Section 31 - Liability for Statements in a Prospectus:** A director will be liable to pay compensation to all persons who subscribe for any shares on the faith of a prospectus, for the loss or damage sustained by reason of any untrue statement in the prospectus.
2. **Section 37 – Liability for Irregular Allotment of Shares:** Where director or officer knowingly contravenes or permits or authorises the contravention of provisions in the Companies Act relating to the allotment of shares, such person may be liable to compensate the company and any allottee for any loss, damages or costs suffered by them.

5 DUTIES AND LIABILITIES OF DIRECTORS IN RESPECT OF INSOLVENT COMPANIES

Section 246 of the Companies Act provides, in its relevant part, as follows:

“Persons Concerned Responsible for Fraudulent Trading

(a) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court, on the application of the Official Receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liability of the company as the Court may direct.

On the hearing of an application under this sub-section the Official Receiver or the liquidator, as the case may be, may himself give evidence or call witnesses.

(b) Where the Court makes any such declaration, it may give such further directions as it thinks proper for the purpose of giving effect to that declaration.”

The general duties which directors owe to the company and the company alone, are subject to one important qualification. When the directors know that the company is insolvent, and continue to trade incurring further liability, they may render themselves personally liable to creditors of the company. We have referred above to Section 246 of the Companies Act. This "fraudulent trading" provision is derived from Section 332 of the English Companies Act 1948 (the current English statutory equivalent is Section 213 of the Insolvency Act 1986. NB:

"wrongful trading" under Section 214 of the Insolvency Act 1986 has no equivalent yet in Bermuda legislation). We believe that Bermuda Courts are likely to follow the approach of English Courts prior to the enactment of the 1986 Insolvency Act and require a high standard of proof of dishonest intent.

Under Section 247 of the Companies Act the court has the power to order restitution, or make such other order as it thinks fit, against a range of people involved in the promotion, formation or management of the company, if it appears, during the winding up of the company, that such a person has appropriated or otherwise misappropriated any of the company's assets, become personally liable for any of the company's debts or liabilities or has otherwise been guilty of any misfeasance or breach of fiduciary duty.

The Companies Act also imposes a duty to cease trading when a company is insolvent and convene a meeting of creditors to put the company into liquidation.

6 MISREPRESENTATIONS

English common law punishes various types of misrepresentation and directors of a company need to be aware of these heads of liability when accepting responsibility for listing particulars which go beyond the content of the listing particulars and are of general application.

6.1 Negligent Misrepresentation

Where a representation is false and causes damage and:-

- a. it is reasonably foreseeable that the representation would be relied upon by the person, or type of persons, claiming damage; and
- b. the relationship between representor and representee is sufficiently proximate, there will be a liability. As regards (i) in the case of listing particulars, a duty of care will generally be owed to subscribers but not purchasers in the secondary market. The requirement in (ii) is almost always established where a statement was made with a view to a contract which it, in fact, induces.

Where a contract has been induced by a negligent misrepresentation it may be rescinded or damages may be awarded. In the absence of contract, damages are the only appropriate remedy.

6.2 Fraudulent Misrepresentation

Where directors make a false statement knowing it to be false, not believing it to be true or recklessly not caring whether it be true or false, they will be liable. The proximity test for negligence is irrelevant here as is contractual nexus; what must be shown is an actual intention that the representee should act upon the representation in the way that caused him loss. Damages are for all losses whether or not foreseeable, and rescission is again available.

6.3 Breach of Contract

If it can be shown that an untrue or misleading statement in listing particulars has become a term of the contract for the acquisition of shares, as opposed to a pre-contractual statement inducing a person to enter into the contract, damages for breach of that contract may be recoverable.

6.4 Criminal Offences

Under the Criminal Code Act 1905 there are various criminal offences in Bermuda with respect to stealing; obtaining property by false pretences etc. which could extend to the actions of directors of a company.

6.5 Conspiracy to Defraud

Conspiracy to defraud is committed where two or more people agree to defraud a person of something to which he is, would or might be entitled. This may occur, for example, where a person is deceived into taking an economic risk which he would not have taken but for the deception.

6.6 Statutory Liability for Misstatements

Directors of a company may be criminally and civilly liable for misstatements in a prospectus issued to the public.

7 TORTIOUS LIABILITIES

Directors are agents of the company, and therefore under the general principles of agency are at risk of being jointly and severally liable with the company for torts committed by it. The case law on this topic is limited since plaintiffs tend to sue the company itself rather than directors. Further, pursuant to the Companies Act, directors would be able to rely on an indemnity against negligent acts.

8 MITIGATION OF LIABILITY ARISING FROM DIRECTORS' DUTIES

Section 98 of the Companies Act provides as follows:

Exemption, Indemnification and Liability of Officers etc.

"98 (1) Subject to sub-section (2), a company may in its bye-laws or in any contract or arrangement between the company and any officer, or any person employed by the company as auditor, exempt such officer or person from, or indemnify him in respect of any loss arising or liability attaching to him by virtue of any rule of law in respect of any negligence, default, breach of duty or breach of trust of which the officer or person may be guilty in relation to the company or any subsidiary thereof; and

(2) Any provision whether contained in the bye-laws of a company or in any contract or arrangement between the company and any officer, or any person employed by the company as auditor, exempting such officer or person from, or indemnifying him against any liability which by virtue of any rule of law which would otherwise attach to him in respect of any fraud or dishonesty of which he may be guilty in relation to the company shall be void.

Provided that –

(a) nothing in this section shall operate to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force; and

(b) notwithstanding anything in this section, a company may, in pursuance of any such provision as aforesaid indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal in which judgment is given in his favour or in which he is acquitted or when relief is granted to him by the Court under section 281"

1. Insurance of Officers

"98A. A company may purchase and maintain insurance for the benefit of any officer of the company against any liability incurred by him under Section 97(l)(b) in his capacity as an officer of the company or indemnifying such an officer in respect of any loss arising or liability attaching to him by virtue of any rule of law in respect of any negligence, default, breach of duty or breach of trust of which the officer may be guilty in relation to the company or any subsidiary thereof and nothing in this Act shall make void or voidable any such policy."

2. Liability of Auditor of Officer

"98B.(1) Where an auditor or an officer is found liable to any person for damages arising out of the performance of any function as such auditor or officer as contemplated by the Act, then the following provisions of the section shall apply.

- (2) An auditor or officer may be liable jointly and severally only if it is proved that he knowingly engaged in fraud or dishonesty.*
- (3) In any case other than that contemplated by sub-section (2) hereof, the liability of the auditor or officer, as the case may be, shall be determined as follows:*
 - (a) the Court shall determine the percentage of responsibility of the plaintiff, of each of the defendants, and of each of the other persons alleged by the parties to have caused or contributed to the loss of the plaintiff. In considering the percentages of responsibility, the Court shall consider both the nature of the conduct of each person and nature and extent of the causal relationship between the conduct and the loss claimed by the plaintiff;*
 - (c) the liability of the auditor or officer, as the case may be, shall be equal to the total loss suffered by the plaintiff multiplied by the auditor's or officer's, as the case may be, percentage of responsibility as determined under paragraph (a) hereof.*
- (4) No auditor or officer whose liability is determined under subsection (3) hereof shall have any liability in respect of any judgment entered against any other party to the action.*
- (5) Except where agreed in writing between the parties, where the liability of an auditor or officer has been determined in accordance with sub-section (3) no other person shall have any right to recover from such auditor or officer any portion of any judgment entered against such other person in respect of the action."*

The Bye-laws of a company typically include both a release and an indemnity in favour of its directors and officers in accordance with Section 98 and authority to provide indemnity insurance.

Thus the Bye-laws of a Bermuda company can exempt directors from negligence and the Company's Bye-laws are so structured. However if the directors are sued in courts outside Bermuda (for example in Singapore) there is no certainty as to how those non-Bermuda courts will view such a wide indemnity.

Please contact any member of the BeesMont Corporate Team for more specific advice on director duties in Bermuda.

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