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REVIEW



**New Guidance on the
Responsibilities and
Duties of Directors
of Isle of Man
Companies**

  
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REVIEW

Introduction

Welcome to our electronic news review published by M&P Legal. We hope that the publication is of interest to recipients. Please contact any of the individuals listed on the contact us page with comments for future articles.



Advocate Christopher J Murphy reviews

....the Isle of Man Supervision Commission's new guidance on the responsibilities and duties of directors of Isle of Man companies.

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New guidance on the responsibilities and duties of directors of Isle of Man companies

In August 2011, the Financial Supervision Commission (“the FSC”) which operates principally as the Isle of Man Government’s regulatory authority for financial services issued detailed guidance on the responsibilities and duties of directors under the laws of the Isle of Man.

Whilst the guidance is aimed primarily at assisting directors of companies holding a financial services licence under the Financial Services Act 2008, the guidance is relevant to all directors of Isle of Man companies. The guidance provides a very useful summary of the key aspects of Isle of Man law in this area and goes some way to correcting a number of common misconceptions about the role and status of company directors in the offshore services arena.

When considering any aspects of Isle of Man company law, the distinction first has to be made between the two separate yet parallel statutory regimes which currently exist. Leaving aside the more exotic corporate manifestations such as limited liability companies, protected cell companies and the like, the “standard” model company, comes in two species in the Isle of Man; those incorporated under the Companies Act 1931-2004 (“1931 Act companies”) and those incorporated under the Companies Act 2006 (“2006 Act companies”).

This basic distinction gives rise to the first

important point to be made about directors of Isle of Man companies. With 1931 Act companies, only natural persons are able to act as directors. Corporate directors are not permitted. With 2006 Act companies, corporate directors are permitted provided they hold the appropriate financial services licence or they are a subsidiary of such licence holder. Whilst there are certain formalities that should be adhered to with respect to the appointment of directors, a further important principle is that a director does not have to be formally appointed in order to be recognised as such under Isle of Man law. The definition of “director” includes persons acting as directors, regardless of how they may otherwise be labelled or described. Consequently, the actions of persons holding themselves out as directors will not generally be invalidated merely by lack of proper appointment. What is important is the substance of the arrangement. The guidance confirms that Isle of Man law recognises a person as a director by his function and the authority and power he in fact exercises. Thus Isle of Man law recognises the notion of a de facto director. The FSC’s guidance further confirms that whilst the term “shadow director” does not appear in either the 1931 Act or the 2006 Act, both Acts make explicit reference to “persons in accordance with whose directions or instructions the directors are accustomed to act”. Thus Isle of Man law recognise the concept of a shadow director. The guidance further confirms that it is contrary to the principles

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of good corporate governance for a company to have shadow directors or to allow persons who have not been properly appointed as directors to act ostensibly in such capacity.

Of particular relevance to offshore businesses and the provision of fiduciary and corporate services is the guidance in relation to so called “nominee” directors. The guidance makes plain that the concept of such nominee directors does not exist in law. All directors are regarded as being subject to the same degree of responsibility and fiduciary duty. A director, who slavishly follows the wishes or orders of others, be they co-directors, shareholders, beneficial owners or other third parties will very likely find him or herself in breach of duty. Merely rubberstamping the decisions of others is unacceptable. The role which the non-executive director plays in terms of objectivity and independence in relation to good corporate governance is recognised but at the same time it is emphasised that Isle of Man law makes no distinction between the standards to be observed by executive and non-executive directors in discharging their duties in law. Such duties include the following:

1. **Loyalty** - A director must act in good faith in what he considers to be the best interests of the company.
2. **Obedience** - A director must act in accordance with the company’s constitution (the memorandum and

articles of association) and must exercise his powers only for the purposes allowed by law.

3. **Independence** - A director must not agree to restrict his power to exercise an independent judgement.
4. **No secret profits** - A director must not use the company’s property, information or opportunities for his own or anyone else’s benefit, unless either the company has agreed to this in general meeting, or the company’s constitution expressly provides for this. It should be noted that consent may not be sufficient in certain circumstances.
5. **Conflicts of Interest** – Directors must exercise great care if a situation arises which could lead to a conflict (actual or potential) between their personal interests and their duties owed to the company or to a third party. A director must account to the company for any benefit received from a transaction that arises from a conflict of interest or duty. This applies whether or not the company sets aside the transaction. Where the company’s constitution expressly permits the transaction, a director will not have to account to the company provided the relevant requirements and terms of the company’s constitution have been strictly adhered to, or where the interest or duty has been fully and properly disclosed to the board of the company.

Sections 103 to 105 of the 2006 Act expressly permit a director of a 2006

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Act company to retain the benefit derived from an interest in a transaction, provided that the director has disclosed his interest to the board of directors of the company. Disclosure must be made as soon as he becomes aware that he has a conflict of interest. Subject to any provision to the contrary in the company's constitutional documents, and having disclosed his interest, a director may participate in any decisions that the board takes in relation to that matter. The duty of directors to disclose any interest to the board of directors of the company is set out in section 148 of the 1931 Act and section 104 of the 2006 Act.

6. **Care, skill and diligence** - A director owes the company a duty to act with the care, skill and diligence that a reasonable person would exercise. In determining whether a director has acted with due care, skill and diligence, consideration will be given to:
 - (a) 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, and
 - (b) the actual knowledge, skill and experience which the director has.
7. **Fairness** - A director must ensure that his dealings with members are conducted impartially.

Whilst it can be seen that the standard of care, skill and diligence expected of a director will generally be that of the "reasonable man" a higher standard is generally considered to be required of those who offer their fiduciary services as directors by way of their profession or business.

Failure to properly discharge the duties and responsibilities of a director will likely result in civil and/or criminal sanction. There is also the possibility of facing disqualification proceedings under the Company Officers Disqualification Act 2009 of Tynwald.

An issue which often arises with respect to the provision of corporate services is the extent to which the professional fiduciary may delegate his powers as a director. Usually the articles of an Isle of Man company will typically permit a certain degree of delegation but this should not be seen as a means of delegating responsibility. Under Isle of Man law directors cannot delegate or abrogate their overall responsibility for the affairs of the company. The directors remain accountable for the exercise of powers even when delegated. The guidance confirms that the directors must adequately monitor the exercise of any delegated powers on an ongoing basis. Key decisions concerning the business and activities of an Isle of Man company which is utilised as part of an offshore structure, will usually refer to transactions being undertaken in other jurisdictions. In these

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circumstances, it is vital for the directors of the Isle of Man company, especially where they are acting in such capacity by way of a fiduciary services business, to be properly engaged in the decision making process in a fully informed manner. Whilst it may be acceptable to delegate the responsibility for formally executing a foreign contract to a third party, absolving oneself from the decision as to whether in principle the contract should be entered into by the company at all, will expose the director to substantial risks. In similar vein, the directors should never act merely as agents of the shareholders or at their direction in relation to the management of the company's affairs. The shareholders cannot determine how the directors should exercise their powers. Under Isle of Man law a very clear line is drawn. It is the directors who are responsible for the management of the company and not the shareholders.

The FSC's guidance also draws together the various relevant principles of Isle of Man law whereby directors may incur personal liability for their actions, both civil and criminal. There are various statutory offences under the 1931 Act and the 2006 Act in relation to compliance with the legislation.

For breach of common law fiduciary duties, a director may be liable to indemnify the company for any losses it may incur. A director may also be required to account to the company for any personal profit

arising through a breach of duty. There is also the possibility for potential liability as a constructive trustee where the director has engaged or assisted in unlawful conduct which has resulted in the director being in receipt of funds or other property.

The statutes themselves also impose personal liability upon directors in certain specific cases of wrongdoing. The statutory concept of fraudulent trading is one such example. Where a director allows the company to continue in business and incur debts to its creditors in circumstances where the director knows there is no reasonable prospect of the debt being met, the director can be held personally liable for such debts.

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