

Acting as a director of a Cayman Islands company

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This briefing note is intended to provide an overview of the duties owed by the directors and other officers of a company incorporated in the Cayman Islands (hereinafter, **directors**, **officers** and **company** respectively), as may be applied by a court in the Cayman Islands. Please note if a director is also a director of a regulated mutual fund he will be subject to additional obligations. For further details please see our briefing note '[Establishing a Cayman Islands Open-Ended Fund](#)'.

Cayman Islands law is largely derived from English common law principles and statutes. Consequently, the duties owed by directors and officers are rooted principally in: (i) general duties derived from English common law which have been adopted into Cayman Islands law by decisions of the Cayman Islands' courts; and (ii) specific duties contained in the Cayman Islands Companies Act (Revised) (**Companies Act**).

In certain circumstances, proceedings in respect of such duties and their alleged breach may be heard in a foreign court applying Cayman Islands law. In such circumstances, the laws of the relevant foreign jurisdiction may apply and legal advice specific to the relevant foreign jurisdiction should also be obtained.

1. Directors – de jure, de facto, shadow and nominee

1.1 In general terms, the directors of a company are those who, collectively, have ultimate responsibility for the conduct of that company's affairs on a day to day basis.

1.2 Most commonly a director will be an individual or body corporate appointed as such in accordance with the company's articles of association. Such a director is known as a 'de jure director'.

1.3 In some circumstances, a person may assume the duties of a director without being validly

appointed to the office of director. Such a director is known as a 'de facto director'.

1.4 Alternatively, a person may be a 'shadow director' within the meaning of the Companies Act. A shadow director, in relation to a company, means a person in accordance with whose directions or instructions the directors are accustomed to act. Third party professional advisors are not shadow directors merely because the directors act on advice given by them in a professional capacity. In the context of a winding up, it is likely that a shadow director will have the same duties and obligations as a formally appointed de jure director, so it is important to be clear as to who is and is not a shadow director of a company.

1.5 Finally, a person may be a 'nominee director'. Such person is typically nominated by a particular shareholder to act as a director. The term is also used in respect of persons who act as directors of a number of companies for an annual fee. For the avoidance of doubt, the duties owed by a director are personal, and it is immaterial that the director has been nominated by another person. Thus, a nominee director, like any other director must act in the interests of the company as a whole, and not simply in the interests of the person or persons by whom he or she has been nominated.

1.6 In his capacity as a director, whether a de jure, de facto, shadow or nominee director, although an individual may be an employee of the company, he is not automatically an employee by virtue of that office. Should a director also be an employee, his service contract may impose duties that are in addition to his or her duties as a director.

2. 'Executive' and 'Non-executive' directors.

2.1 An executive director is part of the company's executive management team, whether as an executive officer or as an employee or both.

2.2 A non-executive director is not part of the company's executive management team, nor is he or she an employee. A non-executive director is, typically, independent of the company, any subsidiaries and any other members of the board.

2.3 A non-executive director is not involved in the conduct of that company's affairs on a day to day basis. Accordingly, he or she must exercise a high-level supervisory role by monitoring the activities of the executive directors and by contributing to the development of strategy.

2.4 Although the nature of their roles is different, there is, as a matter of law, no substantial difference between the responsibilities of an executive director and a non-executive director. Executive and non-executive directors must exercise independent judgment and perform their fiduciary duties when transacting ordinary and extraordinary business on behalf of the company. Although it is common, for example, for the board of an investment fund to delegate certain functions to the investment manager, administrator and accountants, as discussed

more fully below, they must not place undue reliance on such professional service providers.

3. Officers

3.1 In general terms, the officers of a company are those who, collectively, are authorised to act on its behalf in a senior management capacity. The term 'officer' is defined in the Companies Act as including (but is not limited to) a 'manager or secretary', and for certain express purposes, the term also includes 'shadow director'. Under the Companies Act, officers are broadly subject to the same duties as those imposed on a director.

4. Directors' Duties

4.1 The duties of a director under Cayman Islands law can be divided into three main categories:

- (a) Non-fiduciary duties owed at common law, being those of skill, care and diligence;
- (b) fiduciary duties; and
- (c) statutory duties, including under the Companies Act and other statutes.

Non-fiduciary common law duties of skill, care and diligence as a director or officer

4.2 Directors owe duties of skill, care and diligence in the exercise of their powers and in the conduct of the company's affairs. A director is normally only obliged to exhibit such skill as he actually possesses and such care and diligence as would be displayed by a reasonable man in the circumstances. Case law has established that, with respect to the duty of skill, care and diligence (which contains both objective and subjective elements), a director:

- (a) 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 but must act as a reasonable person in his position;
- (b) will be subject to a standard of care commensurate with any particular expertise and/or skills which enable him to meet a higher standard than a director without those skills'
- (c) is not liable for mere errors of judgment;
- (d) unless otherwise agreed, is not required to be an expert in the business of the company, or to possess any particular skill;
- (e) is not bound to attend all meetings (but should attend such meetings as he ought to attend

whenever, in the circumstances, he is reasonably able to do so);

(f) is permitted to delegate powers to service providers of a company but in so doing cannot be absolved from the duty to acquire information about the company's financial affairs or exercise supervisory responsibility for the company (this is discussed more fully below);

(g) if a non-executive director, must attend to the affairs of the company with the level of diligence that, in all the circumstances, is reasonably necessary to enable him properly to ensure that the judgment he exercises is not only independent but also properly informed, and to ensure that his supervision of the executive management is effective.

Fiduciary Duties owed by the Directors to the company

4.3 Directorship is an office, which gives rise to a relationship of trust and confidence, and accordingly to obligations of loyalty, honesty and good faith towards the company. Every director owes these duties individually and they are owed to the company as a whole. In the absence of special circumstances, they are not owed to other companies with which the company is associated, to the directors or to individual shareholders.

There are four main duties:

(a) Bona fide - a director must act loyally, honestly and in good faith in what he considers (and not necessarily what a court might consider) is in the best interests of the company. Ordinarily, a court will therefore only interfere if it determines that no reasonable director could have concluded that a particular course of action was in the best interests of the company. The court is not concerned with the merits of the decision from a commercial point of view.

(b) Proper purpose - a director must exercise the powers that are vested in him for the purpose for which they were conferred and not for some personal or collateral, or some other improper purpose. For example, a company's articles of association may confer on the directors the power to issue additional shares, but it would be an improper exercise of that power if additional shares were issued solely with a view to enabling the directors to maintain personal control of the company in their capacity as shareholders.

(c) Unfettered discretion - a director must not fetter the future exercise of his powers, for example, by agreeing to exercise his powers in accordance with the instructions of some third party. This will be of particular relevance to a nominee director or one who represents a particular shareholder.

(d) Conflict of interest - as a fiduciary, a director must not put himself in a position where there is an actual or potential conflict between his duty to the company and his personal interests or a

duty owed to another person, including a shareholder whom the director represents on the board. It is open to the company, as beneficiary of the fiduciary power, to waive a particular conflict. Under the general common law, such waiver can only be given by the company in general meeting (i.e. the shareholders by a majority vote, once the director has made full disclosure of the conflict or potential conflict). However, invariably a company's articles of association will nowadays provide that, if a director discloses his or her interest to the board at or before the meeting at which a particular matter is to be considered, he or she may vote in respect of that matter, notwithstanding that he is interested in such matter.

Statutory duties

4.4 The Companies Act imposes various specific statutory duties in relation to the internal administration of the company and the registration and filing of certain decisions of and changes to the statutory registers of the company.

4.5 Although not a duty imposed on directors per se, Cayman Islands law also prohibits fraudulent trading. Specifically, if it appears, in the course of the winding up of a company, that any of its business has been carried on with intent to defraud the company's creditors or creditors of any other person or for any fraudulent purpose, the court may declare that any persons who were knowingly parties to carrying on the business in that way are liable to make contributions to the company's assets. Usually, each director will be knowingly a party to ways in which the business of the company is carried on and therefore potentially liable if that business is carried on for fraudulent trading.

5. Delegation

5.1 Provided that the articles of association so provide, directors can delegate any or all of their powers to one or more directors, officers, committees (whether or not such committees comprise persons other than directors or officers) or service providers.

5.2 A director must be diligent and careful in his selection of the persons to whom he delegates any functions. He must reasonably believe any persons to whom he delegates authority to be: (i) honest; and (ii) competent to carry out the functions in question. He must also re-evaluate the terms of delegation and the delegates themselves on a regular basis and ensure that adequate reporting systems are in place to check the performance of the delegated functions and their impact on the nature and condition of the company's business.

5.3 Delegation by the directors of their powers does not relieve directors of their duties to the company. Directors retain ultimate responsibility for exercising supervision and control over the acts of any such delegates. The nature of any such delegation and the appropriate level of ongoing supervision will depend heavily on the precise factual circumstances, including the director's role in the management of the company. Accordingly, directors should consider

taking legal advice, at the earliest opportunity prior to delegating their authority particularly since directors have been found liable in the Cayman Islands for inadequate supervision of those to whom functions have been delegated.

5.4 In selecting their advisors, directors must take reasonable care to ensure that such is qualified to give the advice. Having received the advice, the directors must then exercise their own judgment in the light of that advice.

6. Parties to whom a director owes duties

The company and its shareholders

6.1 In general, a fiduciary relationship will exist between the director and the company, and his fiduciary duties are owed only to, and can only be enforced by, the company. Similarly, his common law duties are generally owed only to the company, and can only be enforced by the company. In certain circumstances, a company's shareholders can enforce duties owed to the company (by derivative action).

6.2 In certain circumstances, directors may, by their actions, place themselves in a principal/agency relationship with the shareholders by virtue of which they owe fiduciary duties to the shareholders.

6.3 It has been found that directors may owe fiduciary duties to individual shareholders, in addition to those which they owe to the company as a whole, in respect of any advice given and action taken by the directors in relation to a shareholder's decision to dispose of their shares. Such a fiduciary duty to shareholders is, however, limited in scope and compensation available to a shareholder in an action for breach of this fiduciary duty will be limited to the loss suffered personally by the shareholder.

6.4 Finally, directors may also, by their actions, place themselves in a position where they owe separate duties at common law to individual shareholders.

Third parties - contract law

6.5 A director is an agent of the company. Accordingly and in keeping with basic agency principles, a director is not personally liable with respect to contracts purporting to bind the company. Contracts between the company and a third party will only bind the company provided that the making of the contract was within the authority of the directors. If, however, a director acts beyond his or her authority, that director may be liable to compensate the other party to the contract for breach of the implied warranty of as to their authority. Directors of a company can also be liable in contract to third parties, if, for example, they give personal

guarantees to banks and others for the performance of the company's obligations.

Third Parties – tort law

6.6 There are two potential situations where a director can be liable in tort. The first is where the company commits a tort (e.g. negligence) through a servant or agent and a director, not being the servant or agent responsible, is liable to the victim. The second is where a director who acts so as to cause the company to be liable in tort, can be sued personally by the victim.

6.7 In the first instance, a director is not liable for the torts committed by a company simply by virtue of his being a director, but he may be personally liable if he has authorised, directed or procured the commission of the tort, even if he did not know, or was not careful, whether the acts so authorised were tortious. It will be a question of fact in each case, and the court will examine what part the director played personally in the commission of the tortious act. In the second instance, the test for personal liability is whether the relevant director has assumed responsibility, either on an actual or imputed basis.

Third Parties – the Court

6.8 Where a company is ordered by the court either to do or to refrain from doing something, or if it gives an undertaking to the court to do or to refrain from doing something, then a director who is aware of the order or undertaking is under a duty to take reasonable steps to ensure that the order or undertaking is complied with. If a director willfully fails to these steps, with the result that the order or undertaking is breached, he can be liable for contempt of court. Thus, a director may be liable for contempt even though he has not actively participated in the breach of the order or undertaking. The failure to supervise or investigate, or willful blindness on his part, will be enough.

6.9 The sanction for contempt of court is a fine or imprisonment, or both.

7. Enforcement and remedies for breach of directors' duties

Enforcement

7.1 Duties may, depending on the duty and the circumstances, be enforced, or the breach of duty prohibited, by court injunction. Breach of the injunction may constitute a contempt of court.

Remedies – Breach of Statutory Duty

7.2 Specific Cayman Islands statutes provide for the imposition of penalties (usually fines or imprisonment, or both), for breaches of statutory duties by directors.

7.3 In circumstances where a company is being liquidated, personal liability may be imposed by statute

(a) on a director for misapplication of company money;

(b) on a director for misfeasance or breach of trust;

(c) on any person, including a director, who is knowingly party to the carrying on of the company's business for fraudulent trading and any such person may be held liable to make such contribution to the company's assets as the court directs.

Remedies – Breach of Common Law and Fiduciary Duty

7.4 Remedies for breach of common law and fiduciary duties include financial compensation to the aggrieved party, restoration of company property, or an account and payment to the company of profits made in breach of duty.

7.5 In all cases, it must be remembered that, in general, in order to succeed in a common law claim and in a claim for breach of fiduciary duty, it will be necessary for the company, shareholder or outsider, to prove (1) the duty (2) breach of the duty and (3) the amount and causation of loss. The degree of proof required is the balance of probabilities.

Remedies in respect of misrepresentation in an offering document

7.6 In the context of shareholder investment, directors may be liable to compensate those who acquire any of the company's shares and suffer loss as a result of any untrue or misleading statement or the omission of any matters stated in the prospectus/offering document.

7.7 A director will, however, have a defence to this liability if he satisfies the court that at the time the prospectus/offering document was submitted he reasonably believed, having made such enquiries as were reasonable, that the statement was true and not misleading (or that the matter omitted which caused the loss was properly omitted) and that he continued in that belief up until the time when the shares were acquired or that they were acquired before it was reasonably practicable to bring a correction to the attention of persons likely to acquire the shares, or that before the shares were acquired, he had taken all such steps as were reasonable for him to take to secure that a correction was brought to the attention of those persons.

7.8 A director will not be liable for any statement made by an expert which is included in the prospectus/offering document with the expert's consent if, at the relevant time, the director reasonably believed that the expert was competent to make the statement.

8. Defences and Reliefs

8.1 Apart from resisting a claim on the basis that there was 'no breach', 'no causation' and/or 'no loss', there may be, depending on the claim, various defences available to a director the subject of a claim for breach of duty. The claim may be time-barred, the Plaintiff may have been contributorily negligent, there may be a claim for indemnity, or the liability of a director to the company or to shareholders may be excluded or limited by the articles of association.

Statutory Relief

8.2 Unlike the UK, there is no express provision made in the existing Companies Act whereby a court may grant a director relief from liability. However, it is considered that such an application may be made under the Cayman Islands courts' inherent jurisdiction, and/or under the Cayman Islands Trusts Law, insofar as the alleged breaches of duty amount to a breach of trust. Relief, if granted, would only be afforded in cases where a director had acted honestly and reasonably and ought fairly to be excused.

8.3 Certain breaches of duty by a director can be ratified (and so absolve the directors) by ordinary resolution, so long as all material facts have been disclosed prior to the passing of the resolution. Breaches of duty involving illegality, fraud or other dishonesty are not capable of ratification in this way.

9. Documenting decisions

9.1 As a matter of corporate governance, it is important that any decisions of the board of directors are appropriately documented in either board minutes or written resolutions. In general, the more important the decision, the more comprehensive any such documentation should be. In the event that the directors' actions are subject to challenge for breach of duty at a later date, the resolutions or minutes can play an important role in providing rebuttal evidence.

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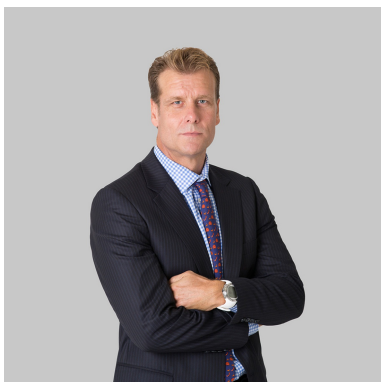
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