What a director of a BVI company needs to know

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Introduction

This guide examines:

- who is a director and to whom a director owes duties;
- the main duties of a director of a BVI company that arise under common law, the BVI Business Companies Act 2004 (the Companies Act) and the company’s memorandum and articles of association (M&A) and the consequences of breaching those duties;
- the main instances (apart from a breach of duty to the company) in which a director may have personal liability under the Companies Act, the Insolvency Act 2003 (the Insolvency Act) and to third parties who enter into dealings with the company;
- the main ways in which a director may be relieved from personal liability; and
- practical steps a director can take to guard against personal liability.

In this guide, company means a company that was originally incorporated under the Companies Act and does not carry on a regulated activity or have securities listed on a securities exchange.

1 Who is a director?

A company is a legal person that is separate and distinct from its shareholders. Since a company is a legal construct, it must act through human agents. It is a long established principle of company law that the directors of a company are its directing mind and will. Under the Companies Act (and normally under the company’s M&A), the directors are given the power to carry on the company’s business.

The Companies Act defines a director as including any person who occupies or acts in the position of director no matter the title given to the person.

In the case of an insolvent company, the Insolvency Act casts the net even wider by defining a director as including any person:

- who occupies or acts in the position of director no matter the title given to the person;
- in accordance with whose directions or instructions a director or the company’s board of directors may be required or is accustomed to act; and
- who exercises, or is entitled to exercise, or who controls, or is entitled to control, the exercise of powers which, apart from the company’s M&A, would fall to be exercised by the board of directors.

Consequently, in some circumstances, a person who has not been formally elected or appointed as a director will be treated as a director and, therefore, will be subject to the duties and liabilities of a director.

2 To whom are duties owed?

Company

The general position is that a director owes duties solely to the company as a whole. This means that the directors must consider the interests of the current and future shareholders of the company.

Where the company has different classes or groups of shareholders which have different interests, the directors must treat each group of shareholders fairly. Where the interests of the current shareholders differ from the interests of current shareholders differ from those of future shareholders, the directors must act in the interests of the company.

Except as noted under Act honestly and in good faith below, where a person is a director of a number of companies within a group, in carrying out the person’s duties as director of a particular company, the person must act in the interests of that company individually and not in the interests of any other group company or the group as a whole.

Shareholders

A director does not owe duties to shareholders (either individually or collectively) by reason only of holding the position of director.

However, a director may act in a way which brings the director into direct and close contact with a shareholder and which creates a special factual relationship between the director and the shareholder.
resulting in the director owing a fiduciary duty to the shareholder. The situations in which a director has been held to owe a fiduciary duty to a shareholder include where the director has:

• been appointed as an agent of a shareholder;
• given advice to a shareholder in the context of a takeover;
• given advice to a minority shareholder on matters affecting its interests on which the minority shareholder relies; and
• bought shares in the company from a shareholder.

Creditors

Where a company is insolvent, or of doubtful solvency, the directors have a duty to consider the interests of the company’s creditors as paramount. This is because the creditors are the ultimate beneficiaries of an insolvent company’s assets. This duty is, however, owed to the company rather than to its creditors.

Who may sue for breach of duty?

Since directors owe their duties to the company, generally only the company may bring an action against a director alleging a breach of duty. This is because the alleged wrong will have been done to the company.

However, if the company will not bring an action against a director alleging a breach of duty, the Companies Act allows a shareholder to bring an action (called a derivative action) against the director on behalf of the company and in the company’s name.

A shareholder must apply to the High Court to get permission to bring a derivative action. The High Court may only give its permission if it is satisfied that:

• the company does not intend to bring an action against the director; or
• it is in the interests of the company that the conduct of the action is not left to the directors or to be determined by the shareholders as a whole.

When considering whether to give its permission, the High Court must consider:

• whether the shareholder is acting in good faith;
• whether the derivative action is in the interests of the company taking account of the views of the directors on commercial matters;
• whether the derivative action is likely to succeed;
• the cost of the derivative action relative to the relief likely to be given; and
• whether an alternative remedy is available.

3 Common law duties

A director owes two types of duty to a company under common law: a duty to exercise care, diligence and skill and fiduciary duties.

Exercise care, diligence and skill

Traditionally, the courts only required a director, when carrying out the director’s duties, to exercise the skills that the director actually had and the care and diligence that may reasonably be expected in the circumstances from a person who had the director’s knowledge and experience.

However, in recent years, the courts have moved towards a more stringent standard of care and now require a director, when carrying out the director’s duties, to take the actions of a reasonable and diligent person having the general knowledge, skill and experience:

• that may reasonably be expected of a person carrying out the same functions for the company as the director; and
• possessed by the director.

A number of principles regarding this duty arise from the cases, including:

• the duty will not be breached by a mere error of judgment;
• where a director claims to have specialist knowledge in a particular area (eg financial or legal matters) the director must display a higher level of skill in those areas;
• a director’s duties are of an intermittent nature and a director is not required to give continuous attention to the company’s business;
• where a task has been delegated to a person (including another director), unless the director has reason to be suspicious, the director may assume that the person has performed the task honestly;
• a director may rely on the advice of an independent expert who is qualified to give the advice; and
• a director has a continuing obligation to acquire and maintain a sufficient knowledge and understanding of the company’s business to enable the director to properly perform the director’s duties as a director.

It is likely that an executive director will be held to a higher standard of care than a non-executive director since an executive director is involved in the day-to-day management of the company’s business and will, therefore, have greater knowledge of the company’s business.

**Fiduciary duties**

A director owes the following fiduciary duties to a company.

**Act in good faith in best interests of company**

A director must act in good faith in what the director considers to be in the best interests of the company as a whole. Where a director is a nominee or an appointee of a particular shareholder or creditor, the director must nonetheless act in the interests of the company rather than in the interests of the shareholder or creditor.

As noted above, this duty requires a director to treat different classes or groups of shareholders with different interests fairly and to balance the interests of the present and future shareholders of the company. As also noted above, where a company is insolvent, or of doubtful solvency, a director is under a duty to consider the interests of the company’s creditors.

This is a subjective duty and a court will not generally interfere with a decision of directors as to what is in the best interests of the company unless:

• there is evidence that the directors did not act in good faith; or
• the court considers that no reasonable director could have concluded that the course of action chosen was in the best interests of the company.

**Exercise powers for proper purposes**

A director may only exercise the director’s powers for the purposes for which they are given. This is an objective duty and applies even where the director will not personally benefit from a course of action or acts in good faith in what the director believes to be in the best interests of the company.

Where a director exercises a power for mixed purposes (some proper and some not), the action will be valid if the primary purpose or substantial purpose was a proper one.

The courts have ruled that:

• issuing new shares is an improper purpose if they are issued to maintain the directors’ control over the company or to defeat the wishes of the majority of shareholders; and
• suspending a shareholder’s voting rights, where the directors believe the response to a disclosure notice regarding beneficial ownership of shares is incorrect, is an improper purpose if they are suspended to stop resolutions being defeated at a shareholder meeting.

**Avoid conflicts of interest**

A director must avoid any conflict of interest (whether actual or potential) between the director’s duty to the company and the director’s personal interests or a duty owed to a third party. This duty may be relaxed for a particular conflict of interests if the conflict is disclosed to, and approved by, the shareholders.

The M&A of most companies will allow a director to have interests and to keep any benefit the director derives from those interests if the director discloses the nature and extent of those interests to the other directors.
Not to fetter discretion

A director has a duty to exercise independent judgment, and when voting on a matter, must consider all relevant circumstances at that time and decide what is in the best interests of the company. Consequently, a director must not fetter the future exercise of the director’s discretion by agreeing to vote on a matter in a predetermined way or in accordance with the directions of a third party.

This duty does not prevent the directors from causing the company to enter into a contract and exercising their powers to ensure that the company complies with its obligations under the contract. If it is in the best interests of the company to enter into the contract, the directors may agree to exercise their powers to ensure that the contract is carried out.

Not to misuse company property

A director is regarded as a trustee of the company’s property. Accordingly, a director may only use the company’s property (including any confidential information and trade secrets) for the benefit of the company. A director must not:

- use the company’s property for the director’s own personal gain;
- accept a benefit from a third party arising from holding office as director; or
- take advantage of a business opportunity arising from holding office as director even if the company is unable to exploit it.

A director may retain a benefit if the director is permitted to do so by the company’s M&A or if the circumstances under which the benefit arises have been disclosed to, and approved by, the shareholders.

4 Statutory duties

General duties

A director has the following general duties under the Companies Act.

Act honestly and in good faith

When exercising the director’s powers or performing the director’s duties, a director must act honestly and in good faith and in what the director believes to be in the best interests of the company.

The Companies Act allows a company’s M&A to modify this duty and states that, if expressly authorised to do so by the company’s M&A, a director may act in a manner which the director believes is:

- (where the company is a wholly owned subsidiary) in the best interests of its parent company, even though it may not be in its best interests;
- (where the company is not a wholly owned subsidiary) in the best interests of its parent company, even though it may not be in its best interests, if the shareholders (other than its parent company) have given their prior approval; and
- (where the company is carrying out a joint venture between its shareholders) in the best interests of a particular shareholder, even though it may not be in its best interests.

Act with care, diligence and skill

When exercising the director’s powers or performing the director’s duties, a director must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances having regard to the:

- nature of the company;
- nature of the decision; and
- position of, and the nature of the responsibilities undertaken by, the director.

Except as noted below, a director may rely on the books, records, financial statements and other information prepared or supplied, and on professional or expert advice given, by:

- an employee who the director believes (on reasonable grounds) to be reliable and competent relating to the relevant matter;
• a professional adviser or expert relating to matters the director believes (on reasonable grounds) to be within the person's professional or expert competence; and
• another director or a committee on which the director does not serve, relating to matters within that director's or committee's authority.

A director may only rely on the matters mentioned above if the director:
• acts in good faith;
• makes proper enquiry where warranted by the circumstances; and
• has no knowledge that reliance on the books, records, financial statements or other information or expert advice is not warranted.

Act for proper purposes

A director must exercise the director's powers for proper purposes.

Comply with Companies Act and M&A

A director must not act, or agree to the company acting, in a way that breaches the Companies Act or the company's M&A.

Disclose interests

A director must disclose to each other director any interest in a transaction entered into, or to be entered into, by the company immediately after becoming aware of it. A director may give a general disclosure to each other director that the director is a shareholder, director or trustee or an officer of a body corporate or other person and is to be regarded as interested in any transaction between the company and that body corporate or other person.

A director need not disclose an interest where the transaction is between the director and the company and the transaction is to be entered into in the ordinary course of the company's business and on usual terms and conditions.

Unless the company's M&A state otherwise, where a director is interested in a transaction entered into, or to be entered into, by the company, the director may:
• vote on a matter relating to the transaction;
• attend, and be included in the quorum for, any directors' meeting at which any matter relating to the transaction is considered; and
• sign a document on behalf of the company, or do any other thing in the director's capacity as a director, that relates to the transaction.

If a director fails to disclose an interest in a transaction which the director is required to disclose the:
• director is liable to a fine of up to US$10,000; and
• transaction is voidable at the option of the company.

The transaction is not voidable if the shareholders approve or ratify the company's entry into the transaction or the company received fair value under the transaction.

However, if the company seeks to avoid a transaction due to non disclosure of an interest, the title or interest in company property acquired by a third party will not be affected if the third party acquired the property:
• from a person other than the company;
• for valuable consideration; and
• without any knowledge of the circumstances of the transaction under which the person acquired the property from the company.

Records and registers

Under the Companies Act, a company is required to keep specified records and registers, including:
• a register of directors, register of shareholders and register of charges;
• all decisions of directors and shareholders (whether passed in writing or at a meeting); and
• records and underlying documents (including financial records) that are sufficient to:
  ◦ show and explain its transactions; and
  ◦ enable its financial position to be determined with reasonable accuracy at any time.

The directors are responsible for ensuring that the company complies with these requirements.

For more information about the records and registers a company must keep, see our guide entitled ‘What documents and records must a BVI company keep?’.

Distributions

The directors of a company may only authorise a distribution if they are satisfied (on reasonable grounds) that it will, immediately after the distribution is made, satisfy the following tests (solvency tests):

• the value of its assets exceeds its liabilities; and
• it is able to pay its debts as they fall due.

The resolution of directors authorising the distribution must contain a statement that, in the opinion of the directors, the company will satisfy the solvency tests immediately after the distribution is made.

If, after a distribution has been authorised but before it is made, a director:

• ceases to be satisfied on reasonable grounds that the company would satisfy the solvency tests immediately after the distribution is made; and
• fails to take reasonable steps to prevent the distribution being made,

• the director is personably liable to repay to the company any part of the distribution that is not recovered from the shareholders.

Significant asset disposals

If a company’s M&A do not state otherwise, where the company proposes to sell, transfer, lease, exchange or otherwise dispose of more than 50 per cent in value of its assets otherwise than in the usual or regular course of its business, the Companies Act requires the following approval process to be followed:

• first the directors must approve the disposal;
• secondly an outline of the details of the disposal must be given to each shareholder irrespective of whether or not the shareholder is entitled to vote on the resolution; and
• thirdly the shareholders must approve the disposal.

This procedure does not apply to a disposal that arises as a result of the creation or enforcement of a security interest over an asset.

Issue of shares for non-cash consideration

Before issuing a share for a non-cash consideration (in whole or part), the directors must pass a resolution stating:

• the amount to be credited for the issue of the share; and
• that, in their opinion, the reasonable present cash value of the non-cash consideration and cash consideration (if any) is not less than the amount to be credited for the issue of the share.

5 Company’s M&A

As mentioned above, the directors have a duty under both the common law and the Companies Act to act within any limits imposed on them by the company’s M&A.

A company’s M&A will normally place a number of duties on directors. These may, for example, include duties to disclose interests, observe procedural requirements relating to meetings, maintain records and registers, ensure that the company’s borrowings do not exceed a set amount or obtain consent from shareholders before taking particular actions.
If the directors exceed their powers under the company’s M&A, they will be in breach of their common law and statutory duties, and consequently, be potentially liable to compensate the company for any loss suffered by it as a result.

6 Delegation

Subject to the Companies Act and any restriction in the company’s M&A, the directors may delegate many of their powers to a committee of directors or to an officer, agent or attorney of the company. The Companies Act prohibits the directors from delegating some of their powers to a committee or an agent (eg power to amend the company’s M&A, establish a committee of directors, appoint or remove a director or an agent or determine that the solvency tests will be satisfied for a distribution).

The directors must properly supervise the actions taken by any committee or person to whom any of their powers have been delegated. The directors cannot avoid their duties to the company by delegating their powers to others.

7 Consequences of breach

Except as noted above, the Companies Act does not specify the consequences of a breach of a director’s statutory duties, so the consequences at common law will apply to a breach of statutory duty.

In general terms, the consequences of a breach of a director’s duties under common law and the Companies Act include, depending on the duty which has been breached, an order that the:

• relevant transaction is to be set aside;
• director must return property to the company;
• director is restrained from continuing to carry on the behaviour causing the breach;
• director must compensate the company or third party for any loss suffered by it as a result of the breach;
• director must pay to the company any profit or gain made by the director; and/or
• director be fined.

Where a breach of duty is alleged against a director, legal proceedings will, depending on the alleged breach, be brought against the director by the board of directors, the company’s liquidator (if the company is in liquidation), a shareholder on behalf of the company in the case of a derivative action or the third party affected by the breach where the director has assumed a duty to the third party.

Depending on the alleged breach, a number of defences may be available to the director, including asserting that there was no breach of duty, the claimant did not suffer a loss or the director did not cause the claimant’s loss, the claimant did not rely on a misrepresentation and a claim is time barred.

8 Other instances of personal liability

Companies Act

The Companies Act states that a director is not liable for any debt, obligation or default of the company except to the extent:

• specifically set out in the Companies Act (eg if the director carries on business while the company has no shareholders, the director will be personally liable for any debt incurred by the company during that period) or in any other legislation; and
• the director may be liable for the director’s own conduct (eg breach of duty or fraud).

However, the Companies Act also states that, where a body corporate commits an offence under it, a director who authorised, permitted or acquiesced in the commission of the offence also commits the offence and, on summary conviction, is liable to the same penalty for the offence. Similarly, under the Interpretation Act 1985, where a body corporate commits an offence, a person who was a director of the body corporate at the time is:

• liable to be prosecuted as though the person had committed the offence; and
• subject to the penalty for the offence as though the person were guilty of committing the offence,
if it is proved to the satisfaction of the court, that the person consented to, connived at, or failed to exercise all reasonable diligence that ought to have been exercised to prevent, the offence having regard to the nature of the person’s duties as director and all the circumstances.

Insolvency Act

If a company enters insolvent liquidation, a director may be potentially liable to a claim under the Insolvency Act by its liquidator on the following grounds.

Misfeasance

A director commits misfeasance if a company enters insolvent liquidation and the director:
• has misapplied or retained or become accountable for any money or other asset of the company; or
• is guilty of any misfeasance or a breach of any fiduciary duty or other duty in relation to the company.

If a director commits misfeasance, the High Court may order the director to repay, restore or account for any money or other asset (or any part of it) or pay compensation to the company in the amount, and interest at the rate, the court considers just.

Insolvent trading

A director will be liable for insolvent trading if the High Court is satisfied that, at any time before the start of the company’s insolvent liquidation, the director knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

If a director engages in insolvent trading, the court may order the director to make a contribution to the company’s assets in any amount the court considers proper. The court cannot make an order if it is satisfied that the director took every step reasonably open to the director to minimise the loss to the company’s creditors.

Fraudulent trading

A director will be liable for fraudulent trading if the High Court is satisfied that, at any time before the start of the company’s insolvent liquidation, any business of the company had been carried on with the intention to defraud the company’s creditors or the creditors of any other person or for any fraudulent purpose.

If a director commits fraudulent trading, the court may order the director to make a contribution to the company’s assets in any amount the court considers proper.

Fraudulent conduct

A director commits fraudulent conduct if, at any time during the period of 12 months before the start of the company’s insolvent liquidation, the director has:
• made or caused any gift or transfer of, or charge on, or caused or permitted the levying of execution against, any of the company’s assets; or
• concealed or removed any of the company’s assets within 60 days of the date of any judgment or order given against the company for the payment of money which remains unpaid.

Fraudulent conduct is an offence punishable on conviction by a fine of up to US$10,000, imprisonment for three years or both. It is a defence if:
• the conduct mentioned in the first bullet point above took place more than five years before the start of the company's insolvent liquidation; or
• the director proves that, at the relevant time, the director did not intend to defraud the company’s creditors.

Third parties

Contract

Where a director executes a contract on behalf of a company in the company’s name, the director is taken to make an implied warranty to the other parties to the contract that the director is authorised to do so.
If a director is authorised to execute a contract on behalf of a company in the company’s name, the director will not be personally liable to a third party for causing the company to enter into the contract. If, however, the director is not authorised to do so, the director may be personally liable for any loss suffered by any other party to the contract as a result of the director breaching the director’s implied warranty of authority.

A director may assume a contractual obligation to a third party by, for example, entering into a contract to guarantee, or create security for, the company’s obligations.

Civil wrongs

Since a company is a legal person that acts through human agents, it will be liable for the civil wrongs (also called torts) committed by its agents within the scope of their authority and its employees within the course of their employment. Under agency law, an agent is also personally liable for any civil wrongs the agent commits.

The issue that often arises is whether, in addition to the company being liable, a director will be personally liable for a loss suffered by a third party as a result of a civil wrong committed by the director or an employee of the company. A claimant may want to sue a director personally if the director has substantial assets or the benefit of an insurance policy.

Where a company commits a civil wrong as the result of an act or failure of a director, the director will be personally liable for the civil wrong if the claimant can satisfy all of the elements necessary to show that the director committed the civil wrong. A director cannot escape liability for wrongdoing by hiding behind the veil of the company on the ground that the director acted on behalf of, and for the benefit of, the company.

However, a director is only likely to be found liable if the director voluntarily assumes responsibility toward the claimant. Consequently, a successful claim is more likely, for example, in the case of fraudulent misrepresentation (where the director will have directly committed fraudulent actions) than negligent misrepresentation (where the director may not have had any direct involvement with the claimant and, therefore, cannot have assumed responsibility towards the claimant).

Where a company commits a civil wrong as a result of an act or failure of an employee or an agent, a director will only be personally liable for the civil wrong if the director authorised, directed or procured the wrongful act (eg procuring an employee to make a fraudulent representation).

A director will not automatically be personally liable for the wrongful acts of a company by reason only of holding the position of director. To be liable, the director must have participated with the company in committing the wrongful act to the extent that it is a joint act done to carry out a common purpose so that the director would be liable for the wrongful act even if the director did not hold the position of director.

9 Relief from liability

No statutory relief

Unlike the position in England and elsewhere, the Companies Act does not have a provision which allows the court to relieve a director from liability for a breach of duty.

Shareholder ratification

Again, unlike the position in England and elsewhere, the Companies Act does not have a provision which gives shareholders the power to authorise or ratify an act of the directors that may otherwise amount to a breach of duty.

However, under common law, the shareholders may authorise or ratify an act of the directors that may otherwise amount to a breach of duty if all material facts are disclosed to them. Where the shareholders do so, the directors will be released from any personal liability to the company.

The shareholders do not have the power to authorise or ratify an act that involves illegality, fraud, dishonesty or the misappropriation of company property. If an act is authorised or approved by a majority of shareholders, a shareholder who did not vote in favour of the resolution may potentially bring an unfair prejudice claim under the Companies Act.
**Indemnity from company**

The Companies Act allows a company to indemnify any current or former director against any expense, judgment, fine or amount paid in settlement and reasonably incurred in connection with any legal, administrative or investigative proceedings brought against the director because the director served as a director of the company if:

- the director acted honestly and in good faith and in what the director believed to be in the best interests of the company; and
- (in the case of criminal proceedings) the director had no reasonable cause to believe that the director’s conduct was unlawful.

An indemnity that breaches the Companies Act is void.

The Companies Act allows a company to pay any expenses incurred by any current or former director in defending any legal, administrative or investigative proceedings before the proceedings are finally concluded if the company is given an undertaking from, or on behalf of, the director to repay all amounts paid by the company if it is ultimately determined that the director is not entitled to be indemnified by the company.

A director may not necessarily be able to rely on an indemnity in the company’s M&A because the director is not party to the M&A. Therefore, it is preferable that the indemnity be included in the director’s service contract or letter of appointment or in a deed of indemnity.

**D&O liability insurance**

The Companies Act also allows a company to buy insurance for any current or former director of the company against any liability asserted against, and incurred by, the director in that capacity even if the company would be unable to indemnify the director.

Ideally, a director should seek a combination of an indemnity from the company and a D&O liability insurance policy because:

- an indemnity from the company will be worthless if the company is unable to pay a claim or becomes insolvent;
- the D&O liability insurance policy may cover liabilities for which the company is unable to indemnify the director; and
- claiming under the D&O liability insurance policy may avoid protracted litigation.

Taking out a D&O liability insurance policy is also beneficial from the company’s perspective because it will not have to pay out under a director’s indemnity if the liability is covered by the insurance policy.

**10 Guarding against personal liability**

It is not possible to provide comprehensive guidance on the actions that a director should take to ensure that the director fulfils the director’s duties and to guard against personal liability, however, as a general guide, a director should seek to:

- be familiar with the company’s M&A;
- take any action necessary to ensure that the director is aware of, and understands, the company’s business;
- actively participate in, or supervise and direct, the conduct of the company’s business;
- attend all board meetings, and where this is not possible, read any board papers and discuss the agenda items with the chairman before and after the meeting or appoint an alternate to attend the meeting;
- read all financial statements, reports and papers sent to the directors;
- ensure that adequate internal controls and risk management procedures are put in place and followed;
- regularly monitor the financial position of the company; ensure that accurate minutes are kept of all meetings of directors and shareholders;
- ensure that the company has competent management in place and actively engage with and (where necessary) scrutinise management;
monitor the activities of any person or committee to whom the directors have delegated any of their powers (eg by requiring regular reports);

avoid any conflict of interests, and where a potential conflict of interest does arise, promptly notify the other directors;

get an indemnity from the company that complies with the Companies Act and is set out in the director's service contract or letter of appointment or in a deed of indemnity; and

ensure that the company keeps in place a D&O liability insurance policy that covers the liabilities that are relevant to the business carried on by the company.

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