Collas Crill explains... Distributions by a Jersey company

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This guide is one in a series of 'Collas Crill explains...' in which we examine areas of Jersey law that frequently arise in practice.

Jersey is a popular place to establish an asset holding **company** because the **Law** is modern, flexible and modelled on English companies legislation.

This guide looks at the key things you need to know about the payment of distributions by a **company**.

Words in bold text are defined at the end of this guide.

Dividends and distributions

Being modelled on English companies legislation, the **Law** previously included provisions which implemented the maintenance of capital rule. This rule required a **company** to maintain its paid up share capital for the benefit of its creditors and limited the sources from which dividends could be paid to shareholders.

As a result, dividends could only be paid from profits (whether earned in the current financial year or previous ones) or distributable reserves.

Today, the maintenance of capital rule has been considerably relaxed and the **Law** allows dividends to be paid from a far wider range of sources. Consequently, the **Law** now uses the term distribution rather than dividend to describe a payment from a **company** to its shareholders. Despite this, the term dividend is still commonly used, including in the **M&A** of many companies.

What is a distribution?

The **Law** defines a distribution as any distribution (whether in cash or otherwise) of a **company's** assets to its shareholders, in their capacity as shareholders, other than any:

- issue of bonus shares;
- redemption or buyback of shares;
- reduction of capital; or
- distribution of assets on a winding up.

A distribution that is made in accordance with the **Law** does not amount to a reduction of capital under the **Law**.

Requirements of Law

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Unlike legislation in other countries, the **Law** is not very prescriptive and allows a **company** considerable flexibility to make distributions. The **Law** has two main requirements.

Solvency statement

The **Law** states that a **company** may only make a distribution if the directors who authorise it make a statement that they have formed the opinion that:

immediately following the date on which the distribution is proposed to be made, the **company** will be able to discharge its liabilities as they fall due; and

- having regard to:
- the prospects of the **company** and to the intentions of the directors with respect to the management of the **company's** business; and
- the amount and character of the financial resources that will in their view be available to the **company**,

the **company** will be able to:

- continue to carry on business; and
- discharge its liabilities as they fall due,

until the first to occur of the expiry of the period of 12 months immediately following the date on which the distribution is proposed to be made, or the **company** is wound up on a solvent basis.

The solvency statement is normally included in the minutes of meetings of directors, which approves the distribution, or in a separate document that is signed by each director who authorised it.

Source of payment

The **Law** states a distribution may be debited to any account of the **company** other than:

- its nominal capital account if it is a par value **company**; or
- any capital redemption reserve.

Therefore, the **Law** does not require a distribution to be paid from profits or distributable reserves or (in fact) that the **company** have any profits or distributable reserves as long as the directors have reasonable grounds for making the solvency statement. Consequently, a **company** may pay a distribution from its:

- share premium account if it is a par value **company**; or
- stated capital account if it is a no par value **company**.

Ratification of distributions

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If:

- a **company** makes a distribution; and
- the directors who authorised the distribution did not make a solvency statement,

the **company** will have breached the **Law** and the distribution will be unlawful.

Where this happens, the **Law** allows the **company** to apply to the Jersey court for an order that the distribution be treated as having been made in accordance with the **Law**.

The court may make the order if it is satisfied that:

- immediately after the distribution was made, the **company** was able to discharge its liabilities as they fell due;
- at the time the application is made, the **company** is able to discharge its liabilities as they fall due;
- (if the distribution was made less than 12 months before the application was made) the **company** will be able to:
- carry on business; and
- discharge its liabilities as they fall due,

until the end of the 12 month period beginning on the date on which the distribution was made; and

- it would not be contrary to the interests of justice to do so.

M&A

General

In addition, to the requirements in the **Law**, a **company's M&A** will normally contain provisions relating to the payment of distributions. The directors of the **company** must make sure they are familiar with these provisions and comply with them.

Sometimes the distribution provisions in the **company's M&A** will be more restrictive than the requirements of the **Law**, especially if the **M&A** have not kept pace with changes to the **Law**. Where this is the case, the directors may want to amend these provisions so the **company** can enjoy the flexibility allowed by the **Law**.

Interim and final distributions

The **Law** does not distinguish between interim and final distributions, however, the **M&A** of most companies continue to do so.

A final distribution is recommended by the directors and declared by the shareholders after the **company's** financial statements have been prepared. Once a final distribution is declared, it is a debt due by the **company** to its shareholders.

In contrast, an interim distribution is declared and paid by the directors during a financial period before the **company's** financial performance for that financial period is known. Unlike a final distribution, the declaration of an interim distribution does not create a debt that may be enforced against the **company** because it may be rescinded by the directors before the payment date.

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Distributions in kind

A **company** will generally pay distributions in cash, however, if its **M&A** allow it to do so, it may also pay a distribution (in whole or part) by transferring specific assets (eg shares or bonds) to its shareholders. This is called a distribution in kind or an *in specie* distribution.

Where a **company's M&A** allow it pay distributions in kind, they normally require the shareholders to approve the distribution in kind.

Typical distribution provisions in M&A

A **company's M&A** typically have provisions relating to distributions which address the following points.

- Subject to the **Law**, the:
- shareholders may declare a final distribution and the amount may not exceed the amount recommended by the directors; and
- directors may pay an interim dividend at any time in an amount they think appropriate.
- A distribution is to be paid proportionately according to the amount paid up on shares. Some **M&A** state that a distribution is to be paid proportionately according to the number of shares held.
- The shareholders may, on the recommendation of the directors, direct that a distribution is to be satisfied in assets rather than cash (ie a distribution in kind).

Potential liability of directors

Solvency statement

A director who makes a solvency statement without having reasonable grounds for the opinion expressed in it is guilty of an offence and, upon conviction, is liable to a fine, imprisonment for up to two years or both.

Breach of duty

If:

- a director authorises a distribution;
- the **company** subsequently becomes insolvent; and
- the Jersey court finds that the director breached the director's duties to act in the best interests of the **company** and to exercise the necessary care, diligence and skill,

the director will be liable to the **company** for any damage suffered by it.

Relief

If an action is brought against a director alleging a breach of the director's duties to the **company**, the director may apply to the Jersey court to be relieved from any liability.

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The **Law** allows the court to relieve the director (in whole or part) from liability for negligence, default or breach of duty, or trust on any terms the court thinks fit if it appears to the court that:

- the director acted honestly; and
- having regard to all the circumstances, the director ought fairly to be excused from liability.

In practice, however, the court is only likely to exercise these powers in favour of a director in rare cases.

Potential liability of shareholders

If:

- a **company** makes a distribution to a shareholder;
- at the time the distribution is made, the shareholder knows, or has reasonable grounds for believing, that the distribution (or part of it) is made in breach of the **Law**; and
- the **company** has not applied to the Jersey court for an order that the distribution be treated as having been made in accordance with the **Law**,

the shareholder is liable to repay the distribution (or part of it) to the **company**.

If the distribution was a non-cash distribution, the shareholder is liable to pay to the **company** a sum equal to the value of distribution (or part of it) at the time at which the unlawful distribution was made.

Terms used

Law means the Companies (Jersey) Law 1991.

company means a Jersey company that is not an open ended investment company.

M&A means a company's memorandum and articles of association.

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