COLLAS CRILL EXPLAINS...CORPORATE BENEFIT IN RELATED PARTY BANKING TRANSACTIONS INVOLVING 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. Further guides will be released weekly, click here to subscribe to receive the rest of the guides in this series to your inbox.

A feature of many banking transactions involving a Jersey company is that the company is required to give a guarantee and/or **third party security** to support the borrowings of a related party.

This guide looks at the key things you need to know about corporate benefit in related party banking transactions.

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

Brief background

The origin of the requirement that a transaction must benefit a company lies in the duties owed by the directors to the company. A company is an inanimate construct that may only act through human agents, normally its directors, who are responsible for managing its business.

Due to their position of responsibility, the directors have Jersey customary law and statutory duties placed on them to (among other things):

- act honestly and in good faith with a view to the best interests of the company;
- exercise the care, diligence and skill that a reasonably prudent person would exercise in similar circumstances; and
- exercise their powers for the purposes for which they were given.

If a company enters into a transaction for which it does not receive any corporate benefit, the directors will be in breach of their duties to the company.

What is corporate benefit?

There is no statutory or generally accepted judicial definition of corporate benefit. The reason is that a transaction must be considered on its merits and corporate benefit assessed in the context of the circumstances surrounding that transaction.

The generally accepted test that is used to assess whether a company will receive corporate benefit from entering into a transaction is whether an intelligent and honest person in the position of a director of the company could, in all the circumstances, reasonably believe the transaction will be for the benefit of the company.

What are the consequences of a lack of corporate benefit?

If a company enters into a transaction that is not in the best interests of, or for a proper purpose of, the company:

- the directors may be personally liable for any loss suffered by the company as a result of entering into the transaction; and
- the company or (if it becomes insolvent) its liquidator may apply to have the transaction set aside if:
- the other party to the transaction party knows; or
- by reason of the other party's relationship with the company ought to know,

that the company's entry into the transaction would amount to a breach by its directors of their duties to the company.

Therefore, to ensure that any guarantee or **third party security** is valid, it is vital that the lender identifies any concern over corporate benefit and ensures that the situation is properly addressed.

When is corporate benefit a concern?

Corporate benefit is frequently a concern in the context of related party banking transactions where a company gives a guarantee and/or **third party security** to support the borrowings of a related party.

Downstream guarantees and security

Where a company:

- is a parent; and
- gives a guarantee and/or **third party security** to support the obligations of its subsidiary (called a downstream guarantee or security),

there should be no concern regarding corporate benefit since the success of a subsidiary is in the interests of its parent.

Upstream and cross stream guarantees and security

However, corporate benefit may potentially be a concern where a company gives a guarantee and/or **third party security** to support the obligations of:

- its parent (called an upstream guarantee or security); or

- a sister company entity (called a cross stream guarantee or security).

If a company is a member of a group, it is not sufficient that the group as a whole benefits from the company entering into a transaction. The company must itself receive a benefit (either direct or indirect) from entering into a transaction.

Indirect corporate benefit

Some examples of indirect corporate benefit that a company may derive from giving a guarantee or **third party security**, include:

- receiving cheaper finance from a group company than could be obtained from a third party lender;
- the right to use intellectual property owned by other group companies;
- trading with other group companies;
- being given business opportunities from other group companies;
- being supplied with cheaper goods or services as a result of the buying power of being part of a group;
- being provided with central administration, management and other expertise from within the group; and
- access to cash pooling arrangements.

How can a lack of corporate benefit be addressed?

Shareholder authorisation

It can often be difficult to tell whether giving a guarantee or **third party security** is in the best interests of a company. Where this is the case, the safest thing to do is to have the company's shareholders authorise it to enter into the guarantee or security document.

Having the shareholders authorise the company to enter into a guarantee or **third party security** is in the interests of both the directors and the lender because it guards against:

- the directors incurring any personal liability from potentially breaching their duties to the company; and
- the guarantee or **third party security** being set aside on the grounds that it was entered into in breach of the directors duties to the company.

Requirements of Law

Under the **Law**, an act or omission of a director will not be treated as a breach of the director's duties under the **Law** to act honestly and in good faith with a view to the best interests of the company and exercise the care, diligence and skill if:

- that act or omission is authorised or ratified by a resolution passed by:

- all of the shareholders of the company; or
- a majority of the shareholders of the company and (if required by the company's articles of association) passed as a **special resolution**; and
- the company will be able to discharge its liabilities as they fall due after that act or omission.

  Where the resolution is only passed by a majority of shareholders, for the purposes of calculating the necessary majority, it is necessary to disregard any votes which may be cast by:

- the director concerned if the director is a shareholder; and
- any shareholder connected (which is defined broadly and includes family members and trusts, foundations and bodies corporate in which the director is interested) with the director.

Solvency

The solvency of the company is essential to the effectiveness of shareholder authorisation. This simply reflects the position under Jersey customary law that the shareholders have no power to authorise the company to enter into a transaction if the company is insolvent or becomes insolvent as a result of entering into it.

If there is any doubt over a company's solvency, it is advisable to get a director to give a certificate confirming the company's solvency.

Terms used

Law means the Companies (Jersey) Law 1991.

special resolution means a resolution that is required to be passed as a special resolution by a majority of two thirds (or any higher majority specified in the company's articles of association) of shareholders who (being entitled to do so) vote at a meeting of the company of which not less than 14 days' notice has been given.

third party security means security given by a company to support the obligations of another person.

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About this guide

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