

Article Information

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Could you be personally liable for your involvement in the business decisions of a company? Shadow and De facto Directors explained

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Shadow and De facto Directors are legitimate types of Directors subject to the same duties, responsibilities and therefore, liabilities, as any company Director. Anyone in a position to make, influence, or guide company or board decisions (with some exceptions) is at risk of being found to be a Shadow Director or De Facto Director and could be subject to fiduciary, common law and statutory Director's duties. **Tim Capelin, Partner** and **Laura Spalding, Lawyer** seek to clarify these concepts and provide some guidance in approaching this issue.

Clive Palmer, a Shadow Director of Queensland Nickel?

In 2016 the administrators of Queensland Nickel ('QN') released a report implicating Clive Palmer as a Shadow Director of QN and asserting that as a Director, he may have contravened his Director's duties. Clive Palmer ceased his Directorship of QN in February 2015 prior to his nephew's appointment as Director and Secretary. In the events leading up to administration, QN was facing financial, workplace health and safety and environmental issues.

The administrators found that Clive Palmer exercised powers in controlling the decisions of the company by expressly approving or rejecting expenditure requests outside of his professional capacity (as a Director of related companies) and by sometimes failing to provide his approval for such requests, controlled QN's ability to carry on company activities. He also played a significant role in QN's day to day operational matters such as supplier contract negotiations, ore supplies and employment and remuneration matters.

If found to be a Shadow Director of QN and to have breached subsequent Director's duties in a court of law, Clive Palmer could face severe penalties and potentially imprisonment. This case highlights the risks that small to large scale family run businesses could be exposed to. If proceedings against Clive Palmer are successful, we are likely to see a rise in litigation against this type of conduct on behalf of creditors making claims against Shadow Directors or even validly-appointed Directors looking to dilute their own accountability.

Non-validly appointed Directors i.e. Shadow or De facto Directors

The concept of Shadow or De facto Directors stems from the definition of *Director* in the Corporations Act 2001 (Cth) ('**the Act**') which is not limited to persons formally appointed to the office.

The definition includes a person who, while not validly-appointed as a company Director and listed on the ASIC register, acts in the position of a Director (**De facto Director**) or whose instructions or wishes the Directors of the company are accustomed to act in accordance with (**Shadow Director**). A Shadow/De facto Director owes the same duties to the company as a formally appointed Director, being someone whom has the potential to control decisions of the company and exercises this power.

There are some exceptions to this definition which will be addressed further on.

Are you a Shadow Director?

The concepts of Shadow or De facto Directors are complex and remain predominantly untested in Australian common law, however there has been some discussion in the courts and so far this is what it tells us about Shadow Directors:

1. Directors or Board members must be accustomed to act in accordance with your wishes. It is not sufficient that executives or employees who are not Directors may be accustomed to act on your instructions or wishes (this may however make you a De facto Director).[1]
2. In terms of being 'accustomed to act' the Directors or Board must perform positive acts (not just desist from acting)[2] and not just on one occasion but over a period of time as a regular course of conduct.[3]
3. The term 'in accordance' requires a causal connection between your instructions or wishes and the action. The instructions or wishes must be related to board activities as opposed to managerial decisions (the distinction being one of fact) but do not have to be in relation to every board activity.[4]
4. Whether or not you have a motive or intention to exercise control or influence over the company is irrelevant.[5] However, whether you have the potential to control is what makes you a Shadow Director, regardless of whether you seek to exercise it or that occasionally the board disregards your advice or influence.[6]
5. A holding company may be a Shadow Director of a subsidiary if the Directors of the subsidiary are nominee Directors who customarily follow the holding company's directions or instructions.[7]

Are you a De facto Director?

A person who acts in the position of a Director and appears to all and sundry to be a Director may be a De facto Director. In *Mistmorn Pty Ltd v Yasseen* (1996) 14 ACLC 1387, proceedings brought by the company and its liquidator, the respondent, although not officially appointed to the position of Director, was found to be a De facto Director and to have breached his fiduciary Director's duties, because it was clear from his involvement in the family company that he was the driving force behind its business dealings.

The limited case law that has interpreted this issue has found that it is not realistic to formulate a general statement as to what constitutes acting as a Director. This remains a question of fact to be considered by a court on a case by case basis.

Exceptions

The Act exempts persons from being found to be Shadow/De facto Directors if they are a professional advisor or where the Act shows a contrary intention.

A person who provides advice in a professional capacity or because of that person's business relationship with the company will not be taken to be a Director merely because the Directors are accustomed to act in accordance with that advice, for example, a lawyer or accountant.

The Act demonstrates a contrary intention to implicate those delegated to carry out standard or minor tasks, typically specific to the role of a Director, as a Shadow or De Facto Director. A note to the definition of 'Director' provides examples of actions a person can undertake without being considered to be a Director. These include the power to call meetings of a company's members, signing minutes of a meeting or providing notices to ASIC of a change of address. These are actions which are relatively inconsequential and do not require the person carrying them out to adhere to Director's duties or hold the same level of accountability as a Director.

Therefore, to avoid being found to be a Shadow or De facto Director, you must avoid exercising duties and powers that involve making decisions, or influencing others to make decisions, exclusive to a Director and which may carry additional duties or accountability.

Recommendations

The ultimate question is who is effectively making board decisions? We recommend identifying those persons, other than professional advisers, who have real influence in or control of, the corporate affairs of the company. It is not necessary that this influence or control should be exercised over the whole field of the company's corporate activities.

This article does not seek to deter managers, CEO's and other executives from executing their duties to the full extent, but encourage them to be more cautious in knowing that their conduct may carry a personal liability.

To those concerned whether they may be found to be a Shadow or De facto Director, consider the following:

- be careful about how you are perceived in respect of the company;
- review your employment agreement and consider negotiating a clause that clearly limits your ability to make or influence board and Director's activities;
- ensure the board does not abdicate its responsibilities and that it still holds Director meetings at which your advice is considered by all members and that minutes of the meeting are taken;
- refrain from making decisions or exercising powers outside the confines of your professional capacity and particularly those exclusive to the role of a Director; and

- seek immediate legal advice.
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[1] *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* at [250] per White J.

[2] *Harris v S* (1976-1977) 2 ACLR 51 at 64 per Wells J.

[3] *Re Unisoft Group Ltd (No 3)* [1994] 1 BCLC 609 at 620 per Harman J.

[4] *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011) 29 ACLC 11-024 (NSWCA) (dismissing an appeal from *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2010) 28 ACLC 10-010).

[5] *Standard Chartered Bank v Antico* (1995) 13 ACLC 1,381; *Re Tasbian Ltd (No 3)* [1992] BCC 358.

[6] Principles formulated by Young JA from Australian and English authorities in *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011) 29 ACLC ¶11-024.

[7] *Standard Chartered Bank of Australia Ltd v Antico* (1995) 131 ALR1.