

SHADOW AND DE FACTO DIRECTORS

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“Shareholders, including parent companies, who have the right to appoint one or more directors to the board of a company should review their working practices in respect of those who represent their interests on the board in question to ensure that they do not exert so much influence that they fall within the definition of a shadow director.”

A shadow director is one on whose directions or instructions are acted on by the board. It is not necessary for the entire board to be accustomed to acting at his direction, merely that a proportion of it does so. In addition, some element of action is required in conformity with his directors; it is not sufficient for him merely to ‘advise’.

While a shadow director owes certain statutory duties and obligations to the company, he is not caught by the full range of fiduciary duties imposed on other directors.

In contrast, a de facto director is one who acts as a director and is treated as such by the board but is not registered as a director. A de facto director must carry

out functions which only the director of a company can perform. The key distinction between a shadow director and a de facto director is that the former does not undertake or agree to act in relation to the company in any particular way nor does he owe any element of ‘loyalty’ to it.

A de facto director, on the other hand, is assuming responsibility for the company itself and is obliged to comply with the full range of fiduciary duties applicable to directors.

It is therefore important for the board to keep under review the individuals to whom it turns for advice and to carry out its instructions, so that all are aware of the obligations they owe at any particular time.

On the question of who must be accustomed to act, this was considered by the High Court in England and it ruled that a governing majority of the board must be accustomed to act in accordance with the directions or instructions of the alleged shadow director. The purpose of the legislation is to catch a person who effectively controls the running of the company by controlling the board.

*T*herefore, a person is unlikely to be within the definition of a shadow director if only one or two directors on a board of several directors follow his instructions.

*O*n the question of how must the directors react to the instructions, the directors must “do something in conformity with” such instructions. It is not sufficient for the alleged shadow director simply to give instructions to the directors; his instructions “must be translated into action by the board”.

*T*he directors must act on the alleged shadow director’s directions as a matter of regular practice; it must be a regular course of conduct of the directors over a period of time.

*F*rom the moment that it can be established that a governing majority of the directors are accustomed to act in accordance with the alleged shadow director’s instructions, then he will owe certain duties to the company.

A shadow director who does not directly deal with the company’s assets does not owe the company any fiduciary duties; e.g. he has no duty to act in the best interests of the company or to not make a profit from his position.

A de facto director owes the same duties to the company as a formally and properly appointed director, i.e. he is subject to both statutory duties and prohibitions, and he also owes fiduciary duties to the company.

CONCLUSION

*S*hareholders, including parent companies, who have the right to appoint one or more directors to the board of a company should review their working practices in respect of those who represent their interests on the board in question to ensure that they do not exert so much influence that they fall within the definition of a shadow director.

*I*n the event that a company enters insolvent liquidation, the liquidator may take action for wrongful trading against shadow and de facto directors, if it appears to him that the board was acting in accordance with their instructions.