WHO IS LIABLE FOR COMPANY DECISIONS?

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WHO IS A DIRECTOR?

Section 9 of the *Corporations Act* 2001 provides that the definition of a director also includes a person who is not validly elected as a director if:

1. They act in the position of a director (often referred to as a de facto director). A de facto director is someone who performs the tasks of a director, but is not formally a director of the company.

   It is important that the person *performs* functions one would reasonably expect to be performed by a director, and this is a question of degree which will depend on the commercial context of the company, its operations and governance structure; or

2. The directors of the company are accustomed to act in accordance with the person's instructions or wishes (often referred to as a shadow director). A shadow director is someone who has enough influence over a majority of the directors to be able to influence company decisions. He or she does not need to be able to influence all facets of the management of the company.

The distinction between being a shadow director and a de facto director is blurred, but that is rarely of much consequence.

CASE EXAMPLE

In the 2012 case of *Grimaldi v Chameleon Mining NL* (No 2), the full Federal Court considered whether Mr Grimaldi was acting in the capacity of a director, and if so, whether he was in breach of any duties in the Corporations Act. The Court determined that although Mr Grimaldi was not an authorised director, he had either abrogated to himself, with the acquiescence of the other directors, or was given by them, functions expected to be performed by a director of the company.

However, the Court said a finding as to whether or not Mr Grimaldi was acting as a director was a distraction. The nature of the decision making in which he participated and the ability he had to affect the company's financial standing meant he was an "officer" as defined by the Corporations Act. As an officer, he had the same duties of care, diligence, and good faith, as well as an obligation not to misuse his position. In their judgment, Justices Finn, Stone and Perram said the following:

> *"We accept that the Board Members seem only to have allowed Mr Grimaldi's attendance at Board meetings by invitation and did not appear to regard him as director as such. However, while they did not hold him out as a director [by that name], they clearly authorised him on occasion to perform functions such as would lead a reasonable third party dealing with him to believe he was acting as a director…"*

A person can be a de facto director even if the company has other active directors and a properly constituted board.

A relevant but not decisive question in determining whether or not someone is a de facto director is whether or not the company itself holds the person out as a director. This can provide some context in determining the true nature of the position held by the person within the company.

ADVISORS AND CONSULTANTS

A person is not caught by the definition merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity (ie accountants or solicitors), or the person has a business relationship with the directors of the company.

However, sometimes it is difficult to know when someone has crossed the line from providing strategic advice to a board, to acting as a director with all the associated liability attached.

The title attributed to the person will be largely irrelevant in determining whether or not they have acted as a shadow director. The important considerations are the nature and extent of their functions and the constraints imposed on their role. This means a specific consultancy arrangement with a company is unlikely to mean the consultant is caught by the definition of "officer". However, if the appointment is to generally assist in managing the affairs of the company, then it could well be caught.

CREDITORS AND FINANCIERS

When a company is facing solvency issues, it is not unusual for a major creditor or financier to provide assistance or instructions with respect to the management of the company. The question then arises whether or not they have sufficient control over the company's board to warrant the conclusion that they are acting as a shadow or de facto director.

The 2011 decision of *Buzzle Operations Pty Ltd (In Liq) v Apple Computers Australia Pty Ltd*, provides useful guidance. The NSW Court of Appeal considered the following circumstances:

- Buzzle was formed as a result of a merger of a number of resellers of Apple. The resellers all had contracts with Apple and had granted it security, so Apple's co-operation was needed to accomplish the merger.
- During the merger discussions, Apple had made its financial and other expectations clear to Buzzle. Apple made a number of demands of Buzzle as a condition for it granting its consent to the merger. The evidence presented at the trial indicated Apple's demands had a significant influence on the directors, to the extent that the directors felt they had no choice but to comply.
- Shortly after the merger, Buzzle became insolvent with debts of about $50 million and went into liquidation. The liquidator made a claim against Apple, saying that its negotiations with Buzzle amounted to it acting as shadow director, and that as a result, it was liable for the insolvent trading debts that Buzzle had incurred.

The Court found that notwithstanding Apple's influence over the directors, they were not accustomed to act in accordance with its directions. Apple was therefore not a shadow director. In reaching this conclusion, the Court said a person is not a shadow director merely because they impose conditions in their commercial dealings with a company, even if the company feels that it has no choice but to comply with those conditions. The directors could still exercise independent judgment about whether or not to comply.

A number of elements need to be proven in order to find that someone acted as a shadow director:

1. There must be a connection between the shadow director's "instructions or wishes" and the company's actions.
2. The majority of the board habitually complied with the shadow director's wishes, so there is an established pattern of compliance. It is not necessary to show that the directors did not exercise any decision making power.
3. The instructions given by the shadow director must have been aimed at the conduct of the directors in their capacity as directors.
4. Where a secured lender gives instructions aimed at the company in its role as debtor, then it will not be acting as a shadow director. This is particularly so if the lender's instructions or wishes are supported by contractual rights in its loan documents.

POSITION OF COMPANY SECRETARIES

Other executives involved in the management of the company can also be liable for company decisions where they have participated in the decision making process.

In *Shafron v ASIC,* the High Court had to consider an appeal by the former general counsel and company secretary of James Hardie Industries. Readers will recall

that the James Hardie prosecutions arose out of a board decision in 2001 to separate two companies from the group that had significant asbestos liabilities. It was later found that the actuarial report supporting the resolution was flawed and that the two companies did not have sufficient assets to meet the claims on the asbestos fund.

The NSW Court of Appeal had found that Mr Shafron was an "officer" of the company, and therefore was liable for breaching his duty, because he was the company secretary and he participated in making decisions that affected a substantial part of the business. In particular, he had failed to advise the CEO that certain additional information concerning the separation proposal should be disclosed to the ASX and he had failed to advise the board that the actuarial report was flawed.

Mr Shafron tried to argue that he was not an officer of the company, because his duties as company secretary were limited to company secretarial functions, and did not extend to his general counsel functions. He also argued that he did not participate in making the decision about the separation proposal because he was not a member of the Board. The High Court rejected Mr Shafron's appeal and found that he had breached his duty as an officer.

The following key points arise from the decision:

- Participation in any decision of a company does not make a person an "officer". The decisions in which the person participates must have significance for the business of the company.
- In determining whether or not there has been a breach of duty, it is important to consider the actual responsibilities of the actual officer, not the usual or statutory responsibilities of a person holding that role.
- A company secretary who has specialised skills or training will be expected to apply those skills in the performance of their role. So, a company secretary with legal or accounting skills is expected to bring those skills to the role. In Mr Shafron's case, he should have provided advice in relation to the ASX disclosure because it was part of his legal skill. He also should have advised about the flaws in the actuarial report because he was familiar with the financial modelling used to prepare it.
- The High Court found that Mr Shafron was an officer of the company because he was a person who participated in making decisions that affected the whole, or a substantial part, of the business of the company. He did not need to "make" the decision in order to "participate". He was a very senior executive and played a large part in informing the Board about matters relevant to the decision, and he proffered advice to the Board about the matter. On that basis, he was an officer and owed duties to the company.

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