

Keeping good companies

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Are administrators liable as shadow directors?

By **Marc Ryckmans**, Solicitor, Abbott Tout Solicitors

The law surrounding shadow directorships and the operation of the professional adviser exemption remains in a state of flux. In the recent case of *Hill v David Hill Electrical Discounts Pty Ltd* (2001) 37 ACSR 617, the Supreme Court, Equity Division, speculated that an administrator of a deed of company arrangement might be a shadow director.

Section 9 of the Corporations Act specifically provides that the term 'director' includes not only a person who is properly appointed to the position of director but also a 'defacto' or 'shadow' director. A 'shadow' director means a person in accordance with whose instructions or wishes the directors of a company are accustomed to act.

The law imposes onerous duties on company directors and there are significant penalties for directors who fail to properly discharge their duties and obligations. In particular, directors can be held liable for insolvent trading. In the context of an administration, the risk is greatly increased whenever a company continues to trade under a deed of company arrangement.

Although to date there has been no reported case of an administrator being found liable as a shadow director, the courts have shown an increasing willingness to hold third parties, including corporate advisers such as accountants and legal advisers, and even controlling shareholders, liable as defacto or shadow directors.

Exception to definition

At first glance, where an administrator exerts control over a company's affairs in a manner that includes issuing instructions to directors, and the directors act in accordance with those instructions, the administrator may be deemed a shadow director. There is, however, an important exception contained in the definition of shadow director that may give protection to an administrator.

The statutory definition of 'director' specifically provides that a person is not a shadow director merely because the directors act on advice given in the proper performance of the functions attaching to the person's professional capacity, or to the person's business relationship with the directors or the company. Whether an administrator can rely on the exemption will depend upon whether his conduct could be said to be in the nature of 'advice' rather than 'instructions or wishes'. The former seems to connote conduct which is merely precatory whereas the latter evokes an element of compulsion.

Previously the legislation referred to 'instructions or directions'. How the word 'wishes' in the place of 'directions' affects the current definition is uncertain. What is certain is that the distinction in the wording is more than merely semantic, having as it does real consequence as to whether a person could be said to fall within or without the definition of shadow director.

The relationship between advice on the one hand and instructions and directions was considered in the English case of *Re Tasbian*. The court held that an accountant, engaged by a company at the instigation of its major shareholder and lender, had potentially exceeded his role as a professional adviser and taken over effective control of the company, thereby exposing himself to possible director liability.

The factors which influenced the court's findings included that the accountant had become a signatory on the company's bank account, he monitored and reviewed the company's trading performance, he negotiated a moratorium with the company's creditors, he dealt with external organisations on the company's behalf, and he was paid for his services by the company.

Ambiguity

The precise ambit of the professional adviser exemption remains ambiguous. What constitutes 'advice' on the one hand and 'instructions or wishes' on the other is unclear. It is suggested that if the exemption is to have any real efficacy, the word 'advice' should be construed as being synonymous with 'Instructions and wishes'.


Provided the conduct engaged in is 'given in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company' then it should not matter whether the conduct is more in the nature of advice rather than instruction and the benefit of the exemption should remain. Viewed in this way, it is the professional capacity that is

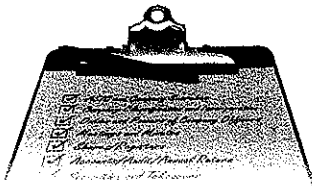
important and not the conduct.

Thus, for example, an administrator who is usually conferred with broad statutory powers akin to those of a director ought not in the exercise of such powers be deemed a shadow director as such conduct is clearly within the ambit of his or her appointment. On the other hand a professional adviser such as a solicitor or accountant who engages in conduct which goes beyond merely giving professional advice may risk becoming a shadow director as it cannot readily be said that such conduct would fall within the ordinary scope of the person's retainer.

The definition of shadow director should not include an administrator acting in the proper performance of his statutory functions. This was certainly the view adopted in the Harmer Report that led to the

introduction of the administration regime. It is relevant to note that the definition of 'officer' in the Corporations Act expressly includes a deed administrator, liquidator and receiver, whereas the definition of 'director' does not.

There is certainly judicial authority for the proposition that receivers and official managers are not shadow directors and therefore not liable under the insolvent trading provisions of the law. The reasoning in those cases ought to equally apply in relation to an administrator. However, until there is clear judicial guidance on the issue, administrators might well be advised to adopt a hands-off approach in the conduct of their administrations or else risk the possible consequences of director liability. 



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