SHADOW DIRECTORS: RECOGNITION, LIABILITIES AND DUTIES

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ABSTRACT

There are different categories of persons involved in the execution of the company's affairs,however the capacity to bind the company as the embodiment of the company itself is limited to a few. Those who exercise acts of management and control over the company's business are usually referred to as the directors. Where persons who satisfy the statutorily prescribed qualification standard and are duly appointed by the shareholders to exercise control and manage the affairs of the company function in that capacity, they are de jure directors. However, the law in protecting individuals who are dealing with the company recognises persons who act as directors even where there is no such appointment, or irregular appointment, not duly appointed as de facto directors. It is difficult to identify a de facto director where the subject company's director is a corporate body. This paper examines the concept of shadow directors who are defacto directors under Nigerian company law the doctrinal methodology is used in this research. The main objective of this study is to analyse the duties and the legal principles for identifying a shadow director it is recommended amongst others that these principles be adopted as used in other jurisdictions.

Keywords: Company, Shadow Director, Director, Companies and Allied Matters Act.

Introduction

Shadow directors have been referred to in early English common law by a variety of colourful epithets such as 'lurking in the shadows' and 'puppet masters'. Early cases descriptively imply a high threshold of control necessary to fulfill the role of shadow director. Later English cases, however, provide more structured limitations to the term and a purposive approach to its interpretation, translating to a lower qualifying threshold.

There has been increasing concern about the need for effective measures to hold those who exercise a significant degree of actual influence or control over the management of companies accountable for their conduct. The formulation of appropriate mechanisms for doing so is particularly problematic where the influence or control is of an indirect nature. The concept of a 'shadow director' was introduced into English law almost a century ago for regulating people who exercise indirect influence or control by giving instructions or directions to a company's board of directors, which the directors are accustomed to obey. Since then several other Commonwealth jurisdictions have also enacted similar specific provisions on shadow directors. The first formal reference to a 'shadow director' in English law was in the Companies (Particulars as to Directors) Act 1917, which extended the term 'director' to include 'any person in accordance with whose directions or instructions the directors of a company are accustomed to act'.

Shadow directorship suggests a background figure, who deliberately conceals his influence over a company's directors. The concept has moved from the time when shadow director was commonly assumed to be a person with a dubious commercial reputation who needed to hide his association with the company from the public and who often could not be formally appointed even if he wished to be because he had been disqualified from acting as a director. This type of director is not formally appointed and is the only type of director without an official record of appointment and removal. These are persons on whose directives and instructions the Board of Directors is accustomed to act. This refers to those who control the decisions of the board from behind the scenes.

A shadow director is a person who is not expressly made a director of a company but in accordance with whose directions the real directors of the company are accustomed to act. It would appear that the Nigerian Law is preoccupied with restricting the scope of who is not a shadow director as opposed to who is. This is clear in section 254(3) where the Act provides that the fact that a person in hi professional capacity gives advice and a director acts on it shallnot be construed to make such a person under this Act a person in accordance with whose directions or instructions the director of a company is accustomed to act. This provision creates a trap which most professionals fall short of and end up as shadow directors.

The law exempts from this definition, a person who, in a professional capacity, provides advice to the directors of a company on which the directors act. A shadow director is described in the case of *Re Hydrodam Corby*, as a person that does not claim or purport to act as a director but lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself. However, it may not be necessary for a shadow director to be someone who "lurks in the shadows", as a person can be a shadow director even if he is involved in the internal management of the company.

The law on shadow directorship is put in place to "pierce the veil" of a company's management in order to determine the persons that are indirectly involved in the management of a company and hold them accountable for the prescribed statutory duties and obligations of a duly appointed director of the company. It is noteworthy that Nigerian Law limits the cover of a shadow director for the purposes of Sections 253, 275 and 281 of CAMA.

Under the United Kingdom Companies Act, a shadow director is recognised as opposed to the Nigerian CAMA which only recognises a shadow director as a director under restrictive circumstances, however the definition of who a shadow director is remains constant with variations as to scope, liabilities and duties. Under the UK Companies Act, a shadow director is a person in accordance with whose directions or instructions the directors of the company are accustomed to act'. Both Acts refer to a shadow director as a 'person' as opposed to 'individual' meaning that a company can also be seen as a shadow director. A shadow director cannot carry out these acts themselves and probably acts behind the scenes, as there is a reason that they cannot be appointed formally. A body corporate will not usually be regarded as a shadow director of its subsidiaries but a 'dominant individual' at the parent company could be.

Generally, the right of a person/company to impose certain conditions on his/its commercial dealings with another company is recognised. Accordingly, a lender entitled to the repayment of a loan and appointment of a receiver can state that it will refrain from exercising its rights only if the borrowing company sells certain assets and in such instances, such a lender will not be found to be a shadow director.

However, in addition to the above, there may be certain situations wherein a **governing majority** of the board of the borrowing company **habitually defers** to the judgment of a lender **over a period of time** such that there is a **causal connection** between the lender's instructions which are **aimed at** the conduct of the directors in their capacities as directors, and the company's actions, shadow directorship may be said to exist between that person and the company.

It was the position of the court in the case of *Ho v Akai Pty Limited (in liquidation) ACN* that "the term "director" includes a person who though not validly appointed as a director is nonetheless a person in accordance with whose instructions or wishes the directors of the company are accustomed to act. Such persons are colloquially referred to as shadow directors". Whilst, there is a dearth of Nigerian case law on this matter, the Australian courts have provided guidance in a recent case of ***Buzzle Operations Pty Ltd (in liquidation) v Apple Computer Australia Pty Ltd.*** In this case, various re-sellers who had acquired stock from Apple on credit decided to merge their businesses into a single entity. Apple consented to the merger and took security over the assets of the new entity. However, the new business was not successful and Apple appointed receivers and managers under its security. Thereafter, the liquidator of Buzzle brought an action against Apple alleging amongst other things that Apple was a shadow director of Buzzle on the basis that Apple had demonstrated a significant level of influence over the affairs of Buzzle. Nevertheless, the court held that reliance could not be placed on these activities to find Apple a shadow director as the activities were basic steps for the operation of the business and things which the directors were in any event going to do.

Whilst the Buzzle case provides clarity on the rights of lenders *vis a vis* borrowing companies, it also highlights the risks taken by lenders who become involved in the affairs of their debtors. Thus, a bank that lends money to a company and nominates directors to the board of the company may run the risk (as a principal) of being found a shadow director. Although Nigerian law on shadow directorship is yet to be tested, the position of the Australian courts provides persuasive authority in respect of same. Consequently, it is expedient for lenders to consider whether the instructions given to the directors of a borrowing company are given in the normal course of their business, i.e. within their rights as lenders.

In practice, identifying him is no easy task. In the first place, the law clarifies that persons who give advice in their professional capacity, upon which directors act, do not fall under this description. This effectively excludes lawyers, auditors and other such professionals periodically engaged by the company for expert advice. It has been suggested that there is no need to show in all cases that the properly appointed directors cast themselves in a subservient role or surrendered their respective discretions. Nevertheless, the words —accustomed to act in section 245 of the CAMA, require some pattern and a single instruction, however significant, will not suffice. In his dealings with the company, the shadow director is bound by the same rules of conduct as the company's directors, especially in those areas where conflicts of interest may arise. However, the UK Court of Appeal in *Ultraframe (UK) Ltd. vs. Fielding*, held that although a shadow director is subject to the requirements imposed by a number of statutory provisions, he does not normally owe fiduciary duties to the company. Perhaps this is because fiduciary duties arise from the fact of one party reposing trust on the other.

Shadow Directors: Circumstantial Directors in Nigeria

The jurisprudence of company law in Nigeria does not recognise a shadow director as a director at all times. The shadow director is only viewed as a director in certain circumstances and held to certain liabilities and duties when these circumstances present themselves. This is also a clear indication of the bias of the Nigeria company law in recognising a shadow director and this is also evident in the dearth of scholarly reactions.

Insolvent Persons Acting as Directors

An insolvent person is precluded from acting as a director. Albeit, where such an infraction occurs such a person is liable on conviction to a fine of N500, or to imprisonment for a term not less than six months or more than two years, or both. It is normal that in such circumstances recourse would be made to the directors duly appointed. It is common that shadow directors are usually persons who cannot be appointed directors for some reasons and being insolvent is not an exception. Based on the foregoing, the CAMA, guards against such infractions by recognising the shadow director as a director properly appointed and holding him to the same prerequisite qualifications as other directors who are duly appointed. Hence, the Act provides thatwhere any person, being an insolvent person, acts as director of or directly or indirectly takes part in or is concerned in the management of any company, he shall be guilty of an offence.

Register of Directors' Share-holding

Every company is expected to keep a register showing as respects each director of the company (not being its holding company) the number, description and amount of any shares in or debentures of the company or any other body corporate, being the company's subsidiary or holding company, or a subsidiary of the company's holding company, which are held by or in trust for him or of which he has any right to become the holder (whether on payment or not).The nature and extent of a director's interest or right in or over any shares or debentures recorded in relation to him in the said register shall, if he so requires, be indicated in the register.

Where a default is made in complying with subsection (1) or (2) of this section (s.275), or if any inspection required under this section is refused, or any copy required thereunder is not sent within a reasonable time, the company and every officer of the company who is in default shall be guilty of an offence and liable to a fine of N500 and if default is made in complying with subsection (8) of this section, the company and every officer of the company who is in default shall be liable to a fine of N50. In listing persons who are to be held liable for theses infractions, section 275 (11) provides that for the purposes of this section:

a) any person, in accordance with whose directions or instructions the directors of a company are accustomed to act, shall be deemed to be a director of the company;

and

b) a director of a company shall be deemed to hold or to have any interest or right in or over, any shares or debentures, if a permanent representative of the body corporate other than the company holds them or has that interest or right in or over them, and either-

i. that permanent representative is accustomed to act in accordance with his directions or instructions; or

ii. he is entitled to exercise or control the exercise of one third or more of the voting power at any general meeting of that body corporate.

The foregoing recognises that a shadow director for the purposes of holding liable persons who are at the helm of the affairs where the register of director's shareholding is not a reflection of the true state of affairs. This would be rationalised on the basis that sometimes shadow directors can be shareholders who own a controlling amount of shares. Hence it is in the best interest of creditors that such state of affairs be protected by law, to prevent any form of concealment under the auspices that a shadow director is not one so appointed. This would also mean that under the said section shadow directors have certain duties imposed on them.

The test for a Shadow Director in the light of Buzzle's case

In the English decision of *Re Hydrodam (Corby) Ltd* it was stated that in order to be a shadow director, the person must have voted or given directions to the company. The English case of *Re Unisoft Group Ltd (No 3),* continued with this relatively high threshold for shadow directors, determining that the control they had to exert had to be akin to a puppet master or the 'cat's paw' controlling the actions of the board. If the whole or the majority of the multi-member board of directors were accustomed to act on his or her directions, that person was considered a shadow director. Later cases of *Secretary of State for Trade and Industry v Deverell,* and *Re Mea Corporation* provide less colourful, but arguably more helpful, guidance in determining who or what defines a shadow director.

In the *Deverell* case, the mischief rule approach was adopted. Lord Justice Morritt stated that the purpose of the legislation is to identify those, other than professional advisers, with real influence in the corporate affairs of the company. But it is not necessary that such influence should be exercised over the whole field of its corporate activities.' The determination of whether it was a direction or instruction was to be 'objectively ascertained by the court in light of all of the evidence;' and it was clear that the board must be accustomed to acting on the instructions or directions of the shadow director.

The CAMA appears not to provide any test for who a shadow director is asides that which can be derived from the description of who a shadow director is. This is largely inadequate considering the new realities of the powers wielded by shadow directors. In this work recourse is made to the Buzzle's case considering the courts pronouncement in highlighting conditions that exist for one to be regarded a shadow director.

In Buzzle's case, Buzzle was created by the merger of six Apple retailers. Apple held a charge over Buzzle's assets. Apple demonstrated a significant level of influence over the affairs of Buzzle, including giving Buzzle advice regarding its structure, management requirements, financial systems, trade terms and so forth. Buzzle heeded to Apple and its financial officer's advice. Buzzle went into Liquidation within months of its establishment. The subject of the second ground of appeal was founded on the premise that Mr.Likidis and Apple acted as "shadow directors" of Buzzle and should therefore be liable for the debts incurred by Buzzle. The key issue was whether Mr.Likidis and Apple were acting as "shadow directors" of Buzzle and whether the liquidator could recover an amount equal to the loss or damage.The appellants appealed on the grounds that the primary judge erred in not finding that Apple and Mr.Likidis were shadow directors, and in finding that the directors of Buzzle made no delegation of their powers to the representatives of Apple, and in failing to find that Apple and/or Mr.Likidis contravened section 588G(2) of the Corporations Act.

The court analysed the individual components of the definition of a "shadow director". The court's interpretation provided useful guidance on how to determine shadow directorship. Young JA considered the definition of "director" as per Corporations Law in 2000 (the same definition as found in Corporations Act 2001). A director is a person who: is appointed to the position of a director unless the contrary intention appears; a person who is not validly appointed as a director if he actsin the position of a director; or a person in accordance with whose instruction and wishes the directors of the company or body are accustomed to act. A person who fits in to the category of paragraph b(ii) can be termed a "shadow director". In accordance with Millett J's comments in *Re Hyrdofoam (Corby) Ltd,* in order to establish a defendant as a shadow director of a company it is necessary to prove:

1. That the directors are used to acting in accordance with the shadow director's instructions. This suggests a causal connection, that is, the wishes or instructions given by the alleged shadow director must cause the relevant decision to be taken by the company. Generally, a certain uniform usage exists in a particular locality and it binds the people who enter into transaction upon the same on the basis of presumed familiarity. In *Agius Ltd. v. Perkins Co.*, the court defined common usage "to mean in accordance with the usual practice in equity or at common law as the case may have been."
2. The directors to whom the instructions are given are the governing majority or real decision makers. Whilst there are problems in situations where the board of the company splits into a majority and minority faction, so long as the influence of the 'outsider' controls the real decision makers, the outsider exerting the influence is likely to be a shadow director.
3. There ought to be a habitual compliance over a period of time- that is, a history of the directors acting in accordance with the alleged shadow director's instructions or wishes. The key factor is that the 'shadow director' has the potential to control to entity. The fact that he or she may not use their power to control every facet of the company, or that from time to time the board disregards the advice, is not the issue.
4. The instructions or wishes of the alleged shadow director must be with regards to board decisions, not managerial activities, to be made by the directors in their capacity as directors, as opposed to their capacity as shareholders or employees etc.

On 9 May 2011 in the New South Wales Court of Appeal, Hodgson JA, Young JA and Whealy JA found that neither Apple nor its representative was a shadow director. The findings of the Court was to the effect that many of the things about which Apple or Mr. Likidis gave instructions were things which the directors of Buzzle said they would have done in any event. For instance, the plaintiffs alleged that Apple instructed the directors to arrange for Buzzle's employees to prepare financial reports, prepare a plan for collection of Buzzle's accounts receivables and employ resources for debt collection. Young JA agreed with the primary judge to the extent that these activities were for the basic operation of any business.

However, Young JA also considered whether the directors of Buzzle had delegated decision-making powers to Apple and Mr.Likidis. The directors were scattered and each was in charge of his own discrete business unit prior to the merger. One particular director had control over a large number of the managerial functions. Therefore Young JA found no reason to deem Apple and Mr.Likidis to be shadow directors of Buzzle, stating that there is a significant difference between a board assigning responsibility for the day to day running of certain activities and formally delegating its collective responsibility for decision making in those areas. The facts in the present case have the matter in the former category. Accordingly, the appeal was dismissed with costs.

The key principles of the shadow director doctrine are to the effect that not every person whose advice is followed by the board is to be classed as a shadow director. In addition, if a person has a genuine interest of their own in giving advice to the board, such as a bank or mortgagee, the mere fact that the board may tend to take that advice to delay enforcement action by the mortgagee will not make the mortgagee a shadow director.

Termination and Appointment of a Shadow Director in Nigeria

A shadow director, *strictosenso* is appointed by no one. In fact, he lurks in the shadows and claims not to be a director. He derives his appointment by virtue of the powers he wields to influence decisions of the board. It is imperative to note that the shadow director is a role assumed only by the giving of instructions and the acting on those instructions. A shadow director ceases to be a director whenever the de jure directors stop acting on instructions from him. In addition, where a shadow director is playing a dual role (of a professional and shadow director), he ceases to be a shadow director when his instructions become restricted to his professional advice and nothing more.

Creditors as Shadow Directors

There is a dearth of Nigerian legislative position on this subject matter, however too often there are cases where a creditor steps in to manage the affairs of a debtor (the company) to keep it afloat to liquidate its liabilities; sometimes this intervention fails. When a company is in the twilight zone, directors ought to act for the benefit of creditors. This position is underpinned by the fact that at this point creditors become the real owners of the company and its residual value and most commercial risks fall on creditors, not the shareholders. Further, waiting till winding-up proceedings commence may amount to shutting the stable door after the horse has bolted, given the important operational and critical financial decisions often made at this point.

In debt restructurings, the question frequently arises as to whether a lender can be considered a shadow director (de facto director) as a result of the latter's involvement in the rescue of the debtor. The reason behind this concern is not due to a trend in case law in this regard. Rulings that have treated lenders as shadow directors were in response to exceptional circumstances that rarely arise in the context of debt restructurings. There are several rulings that have held that the monitoring of a debtor's business activities by a creditor, within the context of the terms agreed in a refinancing agreement, does not constitute shadow directorship. To avoid being considered a shadow director, the creditor must limit its actions to supervising and monitoring and must not interfere in debtor's decision-making procedures. Occasionally it can be difficult not to overstep this limit, particularly if the borrower seeks assistance from the lender and encourages and invites the lender to assist with the management of its affairs.

A person or company is not within the definition (of shadow director) merely because that party imposes conditions on his or her commercial dealings with a company, which the directors feel obliged to comply. A lender who is entitled to demand repayment of a loan and appointment a receiver can say, for example, that it will stay its hand only if the borrowing company sells certain assets. A supplier or buyer might impose conditions because of its superior bargaining power, the directors of the company with whom it deals might feel they have no choice but to comply with those conditions imposed unless something more intrudes, the directors are free and would be expected to exercise their own judgment as to whether it is in the interests of the company to comply with the terms upon which the third party insists, or to reject those terms. If in the exercise of their own judgment, they habitually comply with third party terms, it does not follow that the third party has given instructions or expressed a wish as to how they should exercise their functions as directors.

A Creditor is not a shadow director if directors can make their own decisions. It follows then that if the directors have an opportunity to make their own decisions without a metaphorical gun to their head, then a secured creditor or landlord or someone who has leverage over the company should not be considered to be a shadow director.

In the case of *Re Tasbian*, a financial adviser and chartered accountant, Mr. Nixon, had negotiated an informal moratorium with the company's trade creditors, monitored Tasbian Ltd.'s trading on a monthly, then fortnightly basis, negotiated on the company's behalf with the Department of Trade and Industry and the Inland Revenue, obtained an alteration of the company's bank mandate to add himself as counter signature, negotiated a proposed take-over of the company, and proposed and implemented a group structure including the hive off of employees to a shelf company. While none of these activities on their own were offensive to the role of a financial adviser, the combination of them were determined by the court to potentially take Mr. Nixon's actions beyond that of merely a professional advisor and into the realm of a shadow director. As a result, there are instances where professional advisers can become shadow directors of companies. It is also possible that creditors, including banks, who take on active management roles may be deemed to be shadow directors,but likely not, if they are solely acting to protect their interests in a company. The English judicial view of shadow directors has changed over the years, lowering the threshold of who may qualify. Courts are likely to follow that purposive approach in interpreting the new statutory definition of shadow director, i.e. the *Deverell* test of real influence, with no hard and fast delineation between acting as both de facto and shadow directors.

One of the issues which arose in the Buzzle and Apple case was whether Apple, a secured lender acting in its own interests exercised influence on the directors of a borrower, being Buzzle, should be considered a shadow director and be answerable to insolvent trading allegations. According to Section 9 of the Corporations Act of the UK, a person is a "shadow director" when the directors of the company are 'accustomed to act in accordance with his instructions or wishes'. The court stated that, "the directors of the company with whom it deals might feel they have no choice but to comply with the conditions imposed... this is not sufficient to make the third party who exercises such powers in his dealings with the company a shadow director". Conditions imposed by a third party such as a secured lender do not amount to 'instructions or wishes' because "...the directors are free and would be expected to exercise their own judgment as to whether it is in the interests of the company to comply with the terms upon which the third party insists, or to reject those terms." The decision would provide secured lenders, suppliers and other third parties some comfort in that they are not necessarily considered shadow directors when they exercise influence on the directors of a debtor company to protect their own interests.

In jurisdictions such as the Bahamas, the shadow director is made to emerge from the shadows more frequently. Bahamian company law empowersa liquidator to require a shadow director to submit to the liquidator a statement of affairs of the company; obligatesthe shadow director to co-operate with the liquidator and subjects him to being examined by the liquidator; brings him within the meaning of an "officer" for purposes of liability –for facilitating a transaction in fraud of creditors: for participating in misconduct in the course of the liquidation by impeding the work of the liquidator; for making material omissions in the company's statement of affairs; and to make a contribution in circumstances of insolvent trading.

Shareholders, creditors and financial advisors of Bahamian companies, should understand that the ultimate goal of the shadow director concept is to regulate and protect the public from, unelected persons taking on a corporate management role. Overly active shareholders of private companies, overbearing creditors and intrusive advisers who take on substantive management involvement in Bahamian companies, may well find themselves in the light now being shone upon shadow directors. This position is highly plausible as it calls for accountability and lifts the veil of incorporation where the interest of shareholders and creditors are at risk. Similar provisions are largely lacking in Nigeria hence it is trite to say that the shareholders and creditors are not fully protected or guaranteed remedies when one hides under the cloak of a shadow director to perpetuate infractions of the CAMA and business ethics generally.

Conclusion/Recommendations

This research in examining the concept of directorship under Nigerian company law focused on non-traditional directors who are often simply glossed over by the CAMA. The writer examined how the acts of these defacto directors impose liabilities on them often overlapping in the light of today's realities where directorship is taking a fluid form. The provisions on directors' duties under the CAMA are largely unclear. Hence as opposed to the official record of who the directors are, the business decisions of a company allowed by its articles create room for external persons to make decisions or influence same. The typical directors created by statutory provisions are no longer wide enough to protect innocent third parties who deal with corporate entities. In extant literature it was difficult to place to identify these non-traditional directors. Additionally, issues of whose interests they are to work for and the issues of how to test their powers to determine if they can emerge from the shadows made this research imperative.

It is clear from the foregoing that the recognition of defacto directors is the tool of the law to protect innocent persons who deal with the company. It is recommended that in determining who is a shadow director resort should be made to the principles outlined herein. It must be recognized that a shadow director no longer lurks in the shadows.