

IN FOCUS

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CROSSING THE LINE

Director v. Professional adviser

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Director v. Professional Adviser

Following on from our recent In Focus with respect to shadow directors, this edition focuses on the distinction between directors and professional advisers.

Guidelines

Some guidelines to distinguish between shadow director and professional adviser are as follows:

It is clear from the decided cases that one will have crossed the threshold from independent adviser/banker to shadow director when the duly elected directors effectively abrogate their responsibility for managerial decision making to another party.

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That is, the board of directors acts in accordance with the directions of others rather than exercise its own discretion or judgement (possibly based on the recommendations of others).

The line into shadow directorship may have been crossed when:

- A board agrees to implement all business recommendations made by a third party – without any real consideration, (particularly if some recommendations are to the advantage of the third party);
- A third party leads negotiations with respect to business or management decisions such as debt reorganisation, debt repayments, capital raising, investments and capital expenditure;
- A third party becomes a signatory to the company's bank accounts and makes decisions as to which accounts are to be paid etc (see *3M v Kemish* (1986) 4 ACLC 185 as an example).

Indicia of Professional Adviser

How then does a professional adviser protect against the risk of venturing into the uncharted territory of shadow directorship in the informal workout environment.

- **Terms of engagement** – If acting as advisor to a company in informal turnaround, a written letter of engagement should reflect precisely that point. The advisor is acting in a professional advisory capacity: nothing more, nothing less;
- **Meetings etc** – Minutes of board meetings and

file notes of meetings with suppliers/financiers should reflect the advisor's attendance as observer only.

If the sceptre of shadow directorship is ever raised, such records become vital evidentiary tools for advisors in disproving the existence of shadow directorship.

- **Recommendations** - Inevitably a number of workout strategies may be available to a distressed company.

It is prudent practice on the part of an independent third party advisor to offer a range of options/recommendations to client directors for their due consideration.

The final workout strategy to be adopted is ultimately a decision for the board of directors and recommendations should not be mandated in such a way as to effectively deny the board the capacity to exercise its own discretion.

- **Signatory to company bank accounts** – As a matter of prudence the independent adviser should not become a signatory or authority to the client's bank accounts.

With the advent of the various forms of safe harbour being extolled as a potential solution to the myriad of economic challenges presented by the advent of COVID 19, the High Court decision in (*ASIC vs King*) is a timely reminder to company officers and their professional advisers of the scope of their respective duties and responsibilities.

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