

# IN FOCUS

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## OUT OF THE SHADOWS

HALL CHADWICK 

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The High Court has recently considered the contentious issue of shadow directorship in (ASIC v King) [2020] HCA 4.

## The Law

The concept of shadow or de facto directorship has its genesis in the definition of "officer" in Section 9 of the Corporations Act.

"Officer" of a corporation means:

- a) A director or secretary of the corporation; or
- b) A person
  - i. Who makes or participates in making decisions that effect the whole or a substantial part of the business of the corporation; or
  - ii. Who has the capacity to affect significantly the corporations financial standing; or
  - iii. In accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the personal professional capacity or the business relationship with the directors or the corporation).

Accordingly it is possible to be treated as an officer of a company and subject to the requisite duties and obligations of such, without being formally appointed to the role.

## Facts

The case arose out of the collapse of the MFS Group which can be traced to the aftermath of the GFC.

Mr King was the CEO and executive director of MFS LTD, the parent company of the MFS group of companies. The MFS group provided funds management and financial services including, managed investment schemes. The Premium Income Fund was the largest registered managed investment scheme and MFS Investment Management Pty Ltd "(MFSIM)" was its responsible entity. MFSIM held a \$200 million loan facility with the Royal Bank of Scotland which was to be used solely for the purposes of the Premium Income Fund and not for the use of other companies in the group.

On 17 November 2007 MFSIM and senior personnel in the MFS group including Mr King approved the drawdown of \$150 million under the RBS loan facility.

Ultimately \$103 million of those funds was used to

pay an outstanding debt of MFS Castle Pty Ltd, a wholly owned subsidiary of MFS Ltd to a third party, Fortress which had become due to be repaid.

MFSIM had no liability in respect of this debt and the premium income fund received and there was no evidence of any promise of repayment or security provided.

Perhaps not surprisingly these transactions resulted in multiple contraventions of the Corporations Act.

## Issue

Mr King was not formally a director of MFSIM, his resignation from that office having predated both the entry of the loan facility and the drawdown of the funds.

He endeavoured to avoid liability for a number of breaches of directors penalties initiated by ASIC.

At first instance the Supreme Court in Qld did not accept that contention triggering Para b of the definition of officer in Section 9 of the Act.

On appeal the Court of Appeal in Qld found an implied requirement to be formally appointed to "an office" in MFSIM before liability could be enlivened.

ASIC appealed to the high court.

## Decision

The high court reversed the decision of the Court of Appeal and held that there was no requirement to be formally appointed to the role of director and / or secretary so long as the other criteria in Para b of the Section 9 definition of Officer were triggered.

In other words the court gave effect to those limbs of the definition addressing the concept of shadow directorship.

## Implications

On a purely technical level one might say so what - the high court has simply restated the law and limited if any new principle was established by the decision.

However the decision has to be considered in a practical context.

- There has been a concerted effort in recent years by the government and the regulatory authorities to curb phoenix behaviour. Some of

the most egregious recent examples of phoenix behaviour have involved individuals who were not formally appointed to the role of director;

- Had the Court Of Appeal decision stood, it would have put a spear through the effectiveness of these reforms and set back efforts to regulate the activities of phoenix operators;
- It is not inconsistent with principle for a body corporate to be treated as a de facto or shadow director. Indeed the Corporations Act itself foreshadows this scenario wherein a holding company can be made liable for the insolvent trading of its subsidiary pursuant to Section 588V.

A company (or individual) who is a shadow director of a company will be required to comply with the duties of a director under the Act. These duties include the statutory duties set out in Section 180 – 183 of the Act.

Further a shadow director may be liable for insolvent trading under Section 588G of the Act.

- The High Court itself in the decision foreshadowed the possibility that financiers could find themselves transgressing into the realm of shadow directorship;
- Further notwithstanding these provisions have been around for some time liquidators are still encountering examples of professional advisers such as lawyers, accountants and consultants crossing the threshold from adviser to shadow director.

Indeed it might be anticipated that more professional advisers might fall foul of these provisions if they take a “too hands on approach” to assisting their clients with the economic challenges present by the current COVID 19 environment.

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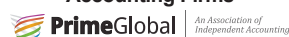


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