Appeal Court guidance on de facto directors

Another attempt to have an individual found liable as a de facto director of a company that has sustained losses has failed. In *Smithton v Naggar*[1], the Court of Appeal has agreed with the trial judge that Mr Naggar was not a de facto director of Smithton Limited (formerly called Hobart Capital Markets Limited).

Background to the case

Hobart was a joint venture company in the Dawnay Day group of companies. Dawnay Day International held just over half of the voting rights in Hobart; Hobart's management held the rest. Mr Naggar was a director (and chairman) of DDI and he was also connected to several of Hobart's major clients. He was not, however, named in the joint venture agreement as one of Hobart's directors and he was never named as a director in any of Hobart's applications for regulatory consents and authorisations.

Background to the law

De facto directors are subject to some (but not all) of the provisions regarding directors in the Companies Act 2006. De facto directorship used to be confined to a person who was acting as director but whose appointment as such was invalid for some reason. Nowadays it is accepted that there is no need for there to have been an invalid appointment for someone to be found to be a de facto director. Lady Justice Arden, giving the only judgement in the Court of Appeal, took the opportunity in this case to set out the basis of liability as a de facto director. She said, following *HMRC v Holland*[2], that liability arises from an **assumption of responsibility** as a director. If there has not been an invalid appointment as director, one must then look at the corporate governance system of the company to see if he or she was doing acts which were "directorial" in nature.

1 [2014] EWCA Civ 939.
2 [2010] 1 WLR 2793.

Decision in the case

In this case it was not necessary to look at the corporate governance system of Hobart as Mr Naggar accepted that his acts were directorial in nature, but he claimed that they had been carried out in a different capacity. Essentially, the case came down to a question of "hat identification". Arden LJ held that the trial judge was entitled to take the view that, since the joint venture agreement set out who would be a director, it was unlikely that other parties would take on the role of director. Having considered many actions and decisions taken by Mr Naggar she concluded that there was nothing that "goes beyond the involvement one would expect to see from a person who combined the roles of major client and chairman of the majority shareholders". In other words, all the acts and decisions that she considered had been taken in some capacity other than that of director of Hobart.

She also drew out a number of points from *Holland* and earlier case law that are useful when looking at whether a person is a de facto director:

- The concepts of shadow director and de facto director are different but there is some overlap.
- A person may be a de facto director even if there was no invalid appointment; the question is whether he assumed responsibility to act as a director. To answer that question the court might have to look at the capacity in which he was acting.
- The court will in general have to look at the corporate governance structure to decide whether the person's acts were directorial in nature.
- The court must look at what the director actually did and not his job title.
- He will not avoid liability if he shows that he in good faith thought he was not acting as a director. It is an objective question.

- The court will look at the cumulative effect of the activities relied on and will look at all the circumstances "in the round".
- It is also important to look at them in their context. A single act might lead to liability in an exceptional case.
- Relevant factors include whether the company considered him to be a director and held him out as such and whether third parties considered that he was a director.
- The fact that a person is consulted about directorial decisions or his approval does not in general make him a director because he is not making the decision.
- Acts outside the period in question may cast light on whether he was a de facto director in the relevant period.

Corporate directors

It is worth mentioning the *Holland* case again in the light of recent statutory developments, as in that case Mr Holland was a director of a company which was itself a corporate director of 43 trading companies. The Companies Act 2006 provided for the first time that from 1 October 2008 every company must have at least one director who is a natural person, i.e. not a corporate director, the intention being that there should always be an identifiable individual "on the hook" for the acts of the company. The law will take this development to its logical conclusion if the Small Business, Enterprise and Employment Bill completes its passage through Parliament in its current form (which looks likely in this respect at least), as this will ban corporate directorships entirely (subject to some exceptions).

Directors' and officers' insurance

On a practical note, it would be a good idea to check the company's D&O insurance policy to see whether de facto and/or shadow directors are covered by it. The relationship between the D&O policy and the company's practice regarding indemnities for directors (QTPIPs) sometimes needs to be examined to make sure the D&O policy works correctly.

Comment

Devi Shah, joint head of our Restructuring, Bankruptcy and Insolvency group, commented "Lady Justice Arden's judgment is helpful in setting out some general factors to be considered in an area which is necessarily highly fact-specific. It is also interesting to note her keen awareness of the commercial reality of the joint venture arrangement in the background, which clearly influenced her and the trial judge's conclusions. The cases on de facto directors continue to suggest that there is a high bar to be met before someone will be held to be one - in contrast to the courts' approach to shadow directors, where they have on a number of occasions found that an individual has been acting as a shadow director".

If you have any questions or require specific advice on any matter discussed in this update, please contact:

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