The English Court of Appeal has given useful guidance on how to determine whether a person is a de facto or shadow director, in Smithton Ltd (formerly Hobart Capital Markets Ltd) v Naggar (10 July).

This question is of crucial importance as persons, such as directors of the holding company, may be considered de facto or shadow directors of a subsidiary despite not having been formally appointed as a director, on account of their function and status. They would therefore subject to additional obligations under the Companies Ordinance (Cap 622) and at common law. Even a single directorial act could lead to liability in an exceptional case.

In Smithton, the English Court of Appeal held that there was no definitive test to determine who was a de facto director. However, the court will generally examine:

- the company’s corporate governance structure to decide whether a person assumed the status and function of a director (e.g. by performing acts directorial in nature) so as to make himself responsible as if he were a director;
- whether the company considered that person to be a director and held him out as such; and
- whether third parties considered that he was a director.

In a more complex scenario, the court may also consider in what capacity the director was acting. For instance, in the case of a person who was a director of a holding company that is its subsidiary’s corporate director, so long as what that person did was done entirely within the ambit of his duties and responsibilities as a director of the corporate director/holding company, his acts would not make him a de facto director of that subsidiary (as in the present case).

As regards the concept of a shadow director i.e. a person in accordance with whose instructions the directors of the company are accustomed to act, the court noted that a person can be both a shadow director and a de facto director at the same time. Also, the role of a de facto or shadow director need not extend over the whole range of a company’s activities. Ultimately, the question of whether a person was a de facto or shadow director is a question of fact and degree.
The case

The claimant, formerly Hobart, is a brokerage company. Hobart was initially set up as a division of a group of financial service companies (DDI), of which the defendant (Naggar) was chairman. Later, Hobart was spun off into a separate joint venture company in which DDI was a majority shareholder. Although under the joint venture agreement Hobart had three directors and three appointees from DDI, Naggar was not one of them.

As part of its work, Hobart undertook contracts for difference (CFDs). In Feb 2007, Naggar concluded that certain shares were undervalued and Hobart began writing CFDs for them, some of which were placed with clients Naggar recommended. In order to hedge the CFDs, Hobart purchased the physical shares and the shares declined in value. DDI collapsed and Hobart sought to recoup its losses of some £4 million by seeking an indemnity from Naggar claiming, *inter alia*, that Naggar had been either a *de facto* or shadow director of Hobart and had acted in breach of his duties owed to Hobart.

The trial judge Rose J dismissed this claim, holding that Naggar was neither a *de facto* nor shadow director. Firstly, there was nothing that went beyond the involvement that one would have expected to see from a person who combined the roles of major client and chairman of the majority shareholder. Secondly, there was no evidence that the majority of Hobart's board were accustomed to acting in accordance with Naggar's instructions. The Court of Appeal dismissed Hobart's appeal and confirmed Rose J's decision. The appellate court held that there was no basis for setting aside the judge's conclusion that Naggar had been involved with Hobart's affairs other than in his capacity as a director of DDI or some other capacity than that of director of Hobart.

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