

### Shadow Directors & De Facto Directors under Gibraltar Law

There may be some doubt as to whether the concept of shadow director exists in Gibraltar Law, especially as the term shadow director is not used at all in the Gibraltar Companies Act. Reviewing UK Legislation the term “shadow director” is first defined in the UK s.63 of the Companies Act 1980 as “a person in accordance with whose directions or instructions the directors of the company are accustomed to act. This wording appears in various provisions of the Gibraltar Companies Act, therefore meaning the concept of shadow director does exist in Gibraltar, and it mirrors the UK definition of the term.

English judicial precedents are therefore helpful in order to better understand what factors are used to determine whether an individual or a corporate entity is a shadow director. A useful starting point is Harman J’s description that the Shadow Director must be in effect “the puppet master controlling the actions of the board” (*Re Unisoft Group*) which in turn implies that his influence stretches across the majority of the company’s directors. If only a minority of directors of the board are accustomed to acting according to a person’s instructions this is not enough to make that person a shadow director (*Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*).

Furthermore, a shadow director must have been giving the majority of directors instructions as a regular practice over a period of time (*Re Unisoft Group*). A one-off instruction, even if accepted by the majority of directors, is unlikely to give rise to the figure of the shadow director.

Perhaps the most comprehensive judicial assessment of the term shadow director was carried out by the Court of Appeal in *Secretary of State for Trade & Industry v Deverell & another* where it was concluded that:

- a. the term should not be narrowly construed;
- b. the giving of non-professional advice could result in a shadow directorship;
- c. the concepts of “direction “ and “instruction” also included advice, as the common feature these terms all share is guidance;
- d. it would be sufficient to show directors had subordinated themselves or surrendered their discretion in the face of guidance from the shadow director (although this element may not always be present);
- e. such guidance did not need to stretch across the whole of the Company’s activities;
- f. the communication did not necessarily have to be understood or expected to constitute a direction;
- g. it was not necessary to show a degree of compulsion in excess of that implicit in the fact the company was accustomed to act in accordance with them (although the most clear example of a shadow directorship is where there is a penalty for not complying with the shadow director’s instructions); and
- h. it is not necessary for the shadow director to “lurk in the shadows”, but this may often be the case.

In practical terms whether a shadow directorship has arisen is a question of fact that must be determined, using the above guidelines, on a case by case basis. For example, a shadow directorship may, but will not necessarily, arise as a result of a parent-subsidiary relationship. In another scenario, a clearing bank may become a shadow director if, as a result of the Company encountering financial difficulties, the board has no option but follow the financial advice imposed by the clearing bank (*Re a company (No 005009 of 1987)*). A “company doctor” appointed by a shareholder in order to assist in a corporate recovery may also render himself liable to being considered a shadow director (*Re Tasabian Ltd No 3*).

Shadow directors are sometimes confused as *de facto* directors, however both terms are not interchangeable, as explained by Millet J in *Re Hydrodan (Corby) Ltd* both terms “are alternates, and in most and perhaps all cases are mutually exclusive”. While the shadow director exerts his influence without holding himself out as a director, a *de facto* director acts as if he were a director without being validly appointed, and rather than exerting his influence over a majority of the board’s directors, his opinion carries at least equal weight to that of the company’s *de iure* directors.

Again, the term *de facto* director does not appear in the Gibraltar Companies Act, however, given that the definition of ‘director’ under Gibraltar Law is identical to the definition under English Law, it is reasonable to infer that this concept also exists in Gibraltar. For example, a person was deemed to be a *de facto* director by virtue that he regularly signed the company’s resolutions, his usual residential address was given as the company’s registered address and board meetings were held at this same address.

The principle reason why it is important to draw a distinction between *de facto* and shadow directors is the different duties that are imposed by law on them. A *de facto* director, by definition, has a greater degree of involvement in the company than the shadow director, and as such, owes the company the same fiduciary duties as the validly appointed directors. In *Re Eurostem Maritime Ltd* Mervyn Davies J held that the words “occupying the position of director” (that also appear in the definition of director in s.2 of the Gibraltar Companies Act) covered any person who *de facto* acted as a director of the company. It is therefore arguable that any duty that is imposed under Gibraltar law to a director is also imposed upon a *de facto* director.

Given that a shadow director’s involvement in the company is not as hands on as a *de facto* director’s, the duties imposed on him under Gibraltar law are much more specific and are limited only to the sections in the Companies Act that refer to “a person in accordance with whose directions or instructions the directors of the company are accustomed to act”.

One should be bear in mind that acting as a shadow director or a *de facto* is not an offence in itself, but the existence of a shadow director and *de facto* director may be a risk indicator and may raise suspicions as to whether these individuals are attempting to conceal something by managing the company but not being listed as a director. More importantly, both the shadow director and *de facto* director must be acutely aware of the duties that are imposed upon them by law so as not to fall short of these requirements.

Finally, it should be kept in mind that the existence of a shadow or *de facto* director could have a direct impact on the place in which the company is deemed to be managed and controlled, which circumstance can lead to important tax consequences.

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